THE FREEMAN
IDEAS ON LIBERTY
VOLUME 59, NO 4 MAY 2009

8 **Do We Need Deposit Insurance?** *by Jeffrey A. Miron*
10 **Mainstream Macro in an Austrian Nutshell** *by Roger W. Garrison*
18 **Global Warming Revisited** *by Michael Heberling*
24 **A Crisis of Political Economy** *by Chris Matthew Sciabarra*
28 **Capitalism: Yes and No** *by Clarence B. Carson*
34 **Ought Implies Can** *by Steven Horwitz*

Page 18

Columns

4 **Ideas and Consequences ~ Who Owes What to Whom?** *by Lawrence W. Reed*
16 **The Therapeutic State ~ The Shame of Medicine: The Case of Alan Turing** *by Thomas Szasz*
22 **Our Economic Past ~ The Two-Price System: U.S. Rationing During World War II** *by Robert Higgs*
37 **Give Me a Break! ~ Making a Bad Bill Worse** *by John Stossel*
47 **The Pursuit of Happiness ~ Organizing and the Organized** *by Charles W. Baird*

Page 22

Departments

2 **Perspective ~ "I, Pencil" Revisited** *by Sheldon Richman*
6 **Regulation Will Stop Future Madoffs? It Just Ain't So!** *by Chidem Kurdas*
40 **Capital Letters**

Book Reviews

42 **Ain't My America: The Long, Noble History of Antiwar Conservatism and Middle-American Anti-Imperialism**
by Bill Kauffman *Reviewed by Christopher Westley*
43 **Mr. Market Miscalculates: The Bubble Years and Beyond**
by James Grant *Reviewed by George C. Leef*
44 **The Trillion Dollar Meltdown: Easy Money, High Rollers, and the Great Credit Crash**
by Charles R. Morris *Reviewed by Michael S. Rozeff*
45 **The Leaders We Deserved (and a Few We Didn't): Rethinking the Presidential Rating Game**
by Alvin S. Felzenberg *Reviewed by Burton Folsom, Jr.*

Page 42

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE FREEMAN
IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
Phone: (914) 591-7230; E-mail: freeman@fee.org
www.fee.org

President Lawrence W. Reed
Editor Sheldon Richman
Managing Editor Michael Nolan
Book Review Editor George C. Leef

Columnists
Charles Baird, Donald J. Boudreaux, Stephen Davies, Burton W. Folsom, Jr., David R. Henderson, Robert Higgs, John Stossel, Thomas Szasz, Walter E. Williams

Contributing Editors
Peter J. Boettke, James Bovard, Thomas J. DiLorenzo, Joseph S. Fulda, Bettina Bien Greaves, John Hospers, Raymond J. Keating, Daniel B. Klein, Dwight R. Lee, Wendy McElroy, Tibor Machan, Andrew P. Morriss, James L. Payne, William H. Peterson, Jane S. Shaw, Richard H. Timberlake, Lawrence H. White

Foundation for Economic Education

Board of Trustees, 2008–2009
Wayne Olson, Chairman
Lloyd Buchanan, William Dunn, Jeff Giesea, Ethelmae Humphreys, Edward M. Kopko, Walter LeCroy, Frayda Levy, Kris Mauren, Roger Ream, Donald Smith

FEE The Foundation for Economic Education (FEE) is a non-political, non-profit educational champion of individual liberty, private property, the free market, and constitutionally limited government.

The Freeman is published monthly, except for combined January-February and July-August issues. Views expressed by the authors do not necessarily reflect those of FEE's officers and trustees. To receive a sample copy, or to have *The Freeman* come regularly to your door, call 800-960-4333, or e-mail mnolan@fee.org.

The Freeman is available on microfilm from University Microfilm International, 300 North Zeeb Road, Ann Arbor, MI 48106.

Copyright © 2009 Foundation for Economic Education, except for graphics material licensed under Creative Commons Agreement. Permission granted to reprint any article from this issue, with appropriate credit, except "Making a Bad Bill Worse."

Cover images: Ames Historical Society

Perspective

"I, Pencil" Revisited

Leonard Read's classic essay, "I, Pencil," is justly celebrated as the best short introduction to the division of labor and undesigned order ever written. But it holds another, largely overlooked lesson as well: "I, Pencil" is an excellent primer in the Austrian approach to capital theory.

Read's pencil describes its family tree, beginning with the cedars grown in northern California and Oregon that provide the wooden slats. But he doesn't really start with the trees. He notes that turning trees into pencils requires "saws and trucks and rope and the countless other gear used in harvesting and carting the cedar logs to the railroad siding," and those things have to be produced before a pencil can be produced.

This is what Austrian economists call a structure of production. This structure is characterized by two closely related elements: multiple stages (distinguished by their "distance" from the consumer) and time. The pencil that eventually emerges at the end of the process must first proceed, in various states of incompleteness, through a series of stations at which components are transformed in ways consistent with making pencils. The stations themselves have to be prepared through earlier stages of production. Thus before trees can be cut down and turned into wooden slats, saws, trucks, rope, railroad cars, and other things must be produced first. Before steel can be used to make saws, trucks, and railroad cars, iron ore must be mined and processed. And so on. The same kind of description can be provided for each component of the pencil: the paint, the graphite, the compound that comprises the eraser, the brass ferrule that holds it.

Tracing the pencil's genealogy back—to iron, zinc, copper, and graphite mines; hemp plants; rubber trees; castor beans; and much more—demonstrates the "roundaboutness" of production, the term of the early Austrian economist Eugen von Böhm-Bawerk. Much time and effort are spent not on making pencils but rather things that will—sooner or later—help to make pencils. Without central direction, entrepreneurs set up production this way because it produces more, better, and cheaper pencils more profitably than some more direct process.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Prices—particularly interest rates—coordinate all this production through time. A quantity of a resource cannot be used both at an early stage of production and a later stage simultaneously. A unit of iron could be devoted to making a ferrule machine or a machine for mining more iron—or many other things in between. Tradeoff is the rule, and consumer welfare depends on having things arranged appropriately. Time preference and the market for loanable funds—that is, interest rates—govern coordination to maximize consumer satisfaction.

Capital equipment wears out. Replacing machines, engines, vehicles, saw blades, and ropes requires money, which requires saving—that is, deferred consumption. Saving is also necessary to finance research and development so that better and cheaper machines, tools, and writing implements might be created. Remember this when Keynesian politicians and economists deride saving.

The stages of the capital structure consist in discrete, specific, scarce, and complementary things—buildings, machines, tools, materials—in particular places at particular times, all of which derive their value from the final goods they help produce. They were put in place as part of entrepreneurs' plans, and in keeping with Austrian subjectivism, the plans give them meaning. A change in a plan might convert equipment that was once complementary to an operation into something of little or no value.

This description of the structure of production should raise no eyebrows. We see it all around. But anyone who has taken a standard economics course will know that capital is usually discussed as though it were a lump of colorless, timeless Play Doh. That conception of capital is amenable to mathematics, but that's a case of the tail wagging the dog. Economics should be a way of thinking about the world we actually confront.

★ ★ ★

When people are nervous about the banking system, the time may not be propitious to ask if we'd be better off without government deposit insurance. But that doesn't keep Jeffrey Miron from asking—and answering—the question.

The current economic turmoil has thrown mainstream macroeconomics itself into turmoil. That should put the spotlight on Austrian macroeconomics. But is the mainstream capable of understanding it? Roger Garrison isn't so sure.

A good reason to oppose government support for scientific research is that the output will tend to be biased toward "crises" that, naturally, require government action. Global warming is a perfect example, writes Michael Heberling.

The collapse of the housing bubble and its consequent financial disorder are signs of problems far deeper than most people think. They reveal a crisis not of the free market but of "capitalism." Chris Sciabarra resolves the paradox. In a related article, a *Freeman* reprint, the late Clarence Carson also expresses doubts about "capitalism."

In discussions of public policy there is no shortage of things we are told we *must* do. Few people bother to ask whether they *can* be done. Steven Horwitz does.

Our columnists have burning issues on their minds. Lawrence Reed wants to know what we owe each other. Thomas Szasz tells the tragic story of scientific genius Alan Turning. Robert Higgs discusses World War II price controls. John Stossel says protectionism made the so-called stimulus bill even worse. Charles Baird documents union abuse of workers who don't want representation. And Chidem Kurdas, confronting those who say the Bernard Madoff Ponzi scheme justifies more government regulation, replies, "It Just Ain't So!"

Coming under the reviewers' microscopes are books on antiwar America, the bubble and the burst, and rating presidents.

Capital Letters features an exchange between Leland Yeager and Michael Giuliano over utilitarianism.

—*Sheldon Richman*
srichman@fee.org

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Who Owes What to Whom?

BY LAWRENCE W. REED

For a society that has fed, clothed, housed, cared for, informed, entertained, and otherwise enriched more people at higher levels than any in the history of the planet, there sure is a lot of groundless guilt in America.

Manifestations of that guilt abound. The example that peeves me the most is the one we often hear from well-meaning philanthropists who adorn their charitable giving with this little chestnut: "I want to give something back." It always sounds as though they're apologizing for having been successful.

Translated, that statement means something like this: "I've accumulated some wealth over the years. Never mind how I did it, I just feel guilty for having done it. There's something wrong with my having more than somebody else, but don't ask me to explain how or why because it's just a fuzzy, uneasy feeling on my part. Because I have something, I feel obligated to have less of it. It makes me feel good to give it away because doing so expunges me of the sin of having it in the first place. Now I'm a good guy, am I not?"

It was apparent to me how deeply ingrained this mindset has become when I visited the gravesite of John D. Rockefeller at Lakeview Cemetery in Cleveland a couple years ago. The wording on a nearby plaque commemorating the life of this remarkable entrepreneur implied that giving much of his fortune away was as worthy an achievement as building the great international enterprise, Standard Oil, that produced it in the first place. The history books most kids learn from these days go a step further. They routinely criticize people like Rockefeller for the wealth they created and for the profit motive, or self-interest, that played a part in their creating it, while lauding them for relieving themselves of the money.

More than once, philanthropists have bestowed contributions on my organization and explained they were "giving something back." They meant that by giving to us, they were paying some debt to society at large. It turns out that, with few exceptions, these philanthropists really had not done anything wrong. They made money in their lives, to be sure, but they didn't steal it. They took risks they didn't have to. They invested their own funds, or what they first borrowed and later paid back with interest. They created jobs, paid market wages to willing workers, and thereby generated livelihoods for thousands of families. They invented things that didn't exist before, some of which saved lives and made us healthier. They manufactured products and provided services, for which they asked and received market prices. They had willing and eager customers who came back for more again and again. They had stockholders to whom they had to offer favorable returns. They also had competitors, and had to stay on top of things or lose out to them. They didn't use force to get where they got; they relied on free exchange and voluntary contract. They paid their bills and debts in full. And every year they donated some of their profits to lots of community charities no law

Lawrence Reed (lreed@fee.org) is the president of FEE. This column first appeared in the February 2002 issue.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

required them to support. Not a one of them that I know ever did any jail time for anything.

So how is it that anybody can add all that up and still feel guilty? I suspect that if they are genuinely guilty of anything, it's allowing themselves to be intimidated by the losers and the envious of the world—the people who are in the redistribution business either because they don't know how to create anything or they simply choose the easy way out. They just take what they want, or hire politicians to take it for them.

Or like a few in the clergy who think that wealth is not made but simply "collected," the redistributionists lay a guilt trip on people until they disgorge their lucre—the Tenth Commandment ("Thou shalt not covet") notwithstanding. Certainly, people of faith have an obligation to support their church, mosque, or synagogue, but that's another matter and not at issue here.

Real Giving Back

A person who breaches a contract owes something, but it's to the specific party on the other side of the deal. Steal someone else's property and you owe it to the person you stole it from, not society, to give it back. Those obligations are real and they stem from a voluntary agreement in the first instance or from an immoral act of theft in the second. This business of "giving something back" simply because you earned it amounts to manufacturing mystical obligations where none exist in reality. It turns the whole concept of "debt" on its head. To give it "back" means it wasn't yours in the first place, but the creation of wealth through private initiative and voluntary exchange does not involve the expropriation of anyone's rightful property.

How can it possibly be otherwise? By what rational measure does a successful person in a free market, who has made good on all his debts and obligations in the traditional sense, owe something further to a nebulous entity called society? If Entrepreneur X earns a billion dollars and Entrepreneur Y earns two billion, would it make sense to say that Y should "give back" twice as much as X? And if so, who should decide to whom he owes it? Clearly, the whole notion of "giving something back" just because you have it is built on intellectual quicksand.

It cheapens the powerful charitable impulse that all but a few people possess to suggest that charity is equivalent to debt service or that it should be motivated by any degree of guilt or self-flagellation.

Successful people who earn their wealth through free and peaceful exchange may choose to give some of it away, but they'd be no less moral and no less debt-free if they gave away nothing. It cheapens the powerful charitable impulse that all but a few people possess to suggest that charity is equivalent to debt service or that it should be motivated by any degree of guilt or self-flagellation.

A partial list of those who honestly do have an obligation to give something back would include bank robbers, shoplifters, scam artists, deadbeats, and politicians who "bring home the bacon." They have good reason to feel guilt, because they're guilty.

But if you are an exemplar of the free and entrepreneurial society, one who has truly earned and husbanded what you have and have done nothing to injure the lives, property, or rights of others, you are a different breed altogether. When you give, you should do so because of the personal satisfaction you derive from supporting worthy causes, not because you need to salve a guilty conscience. FEE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Regulation Will Stop Future Madoffs? It Just Ain't So!

BY CHIDEM KURDAS

Bernard Madoff is a boon to financial regulation advocates. A well-known Wall Street figure, he confessed to defrauding his clients of $50 billion, an amazing number. It is now established conventional wisdom, blared across the media, that this and other financial disasters would likely not have happened had there been proper government supervision.

With deregulation fingered as the culprit, the new occupants of Congress and the White House are expected to infuse regulatory bureaucracies with greater authority and resources.

Commentators cite the Madoff affair as proof positive against the free market. "The long, bipartisan experiment with financial deregulation has failed utterly," declared Tim Rutten in the *Los Angeles Times*. "The Madoff scandal should be a wake-up call," wrote Arthur Levitt in the *Wall Street Journal*, calling for more regulation of investment advising.

Charles Ponzi, 88 years before regulators failed to stop Bernard Madoff from repeating his fraud.

Levitt headed the Securities and Exchange Commission from 1993 to 2001—a period that covers the early stage of the debacle—and knew Madoff personally. He says he did not suspect wrongdoing.

In this case, as in an earlier fraud case I've studied, regulators in effect facilitated the deception. People made mistakes in part because of the assurance provided by government oversight. It is remarkable that a massive government failure of eight or nine years' duration has turned into an argument for market failure and more government.

Bernard Madoff Investment Securities was a major broker-dealer that executed a large number of trades on the Nasdaq and made markets for certain securities. Madoff, a pioneer in electronic trading, had helped build the Nasdaq electronic market. He was so well respected that regulators would ask his opinion about the trading system.

As a brokerage the firm was heavily regulated by several agencies, with the SEC as the primary overseer. Besides mediating trades, Madoff traded with other people's capital. He appeared to be unusually successful at this, making around 15 percent annually over a couple of decades with nary a losing year.

There were rumors about those stable profits. How could it be that this one man made money during times when others used the same strategy, traded the same securities, and made losses? An obvious explanation was that Madoff exploited his market-making position, from which he knew when there were significant purchases or sales that could raise or lower the price of a security. Taking advantage of the information, he could buy or sell ahead of the trades his brokerage executed. This would give him a huge edge over other traders and explain the exceptional steadiness of his returns. He could not tell people this was the source of his profits, though, since "front-running," as it is known, is illegal.

The other explanation was that he was not making the returns he claimed to make—he was engaged in a garden-variety fraud often called a Ponzi scheme. He may have made money initially by front running but

Chidem Kurdas (chidem.kurdas@att.net) is a financial journalist in New York. She writes investment analysis on HedgeFundSmarts.com and policy news spoofs on JenniferKerfuffle.com.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

stopped doing that because he feared getting caught. Later he fell into the scheme of fabricating returns and paying some investors with other investors' money. Only Madoff knows what happened.

In any event, his beyond-belief performance was brought to the attention of the SEC and other agencies by at least two people acting independently. One was a hedge fund manager named Michael Berger, who was himself apprehended for concealing losses from investors in Manhattan Investment Fund.

In an attempt to get leniency from the government, Berger in early 2000 offered the SEC, the FBI, and the U.S. Attorney's office information about Madoff and other dubious ventures. He told me and other journalists about this. In 2001 and 2002 several articles appeared in the press expressing doubts about various aspects of the Madoff operation.

Arthur Levitt suspected no wrongdoing when he headed the SEC.
Photo courtesy Arthur Levitt

Authorities had already heard about the matter from Harry Markopoulos, an analyst and trader frustrated because he failed to achieve the robust returns Madoff reported. Markopoulos used quantitative analysis to demonstrate that Madoff could not make the returns he claimed with the derivatives trading strategy he said he used. Starting in 1999 Markopoulos repeatedly discussed the matter with government officials and even submitted a report documenting his case.

The SEC investigated Madoff Securities several times. The examiners found minor violations of a technical sort but no big problem. Madoff paid a fee, fulfilled a requirement to register as an investment adviser, and was allowed to go on his way.

People who invested their own or their clients' money with Madoff saw the press reports and heard about the SEC examinations. For instance, a Swiss bank that channeled capital to him had concerns, but according to an internal letter the executives "found comfort" that the brokerage was subject to routine audits by the SEC and FINRA, a nongovernment industry regulator.

Regulators discovered no fraud after repeated complaints and inspections. That reassured investors and aided Madoff's game, which was officially recognized only after he confessed in December 2008—after, possibly, decades of cheating.

The Usual Fiasco

This regulatory fiasco is not unique. Berger had a similar pattern, as I show in the Winter 2009 issue of *The Independent Review*. Berger was able to hoodwink investors, accountants, and auditors for three years partly because an SEC-regulated broker-dealer backed him up.

These government failures are not due to lack of regulatory laws, authority, or personnel, despite an understandable campaign to make it look that way. SEC examiners had every authority to look into any aspect of the Madoff operation. Markopoulos, the analyst, offered his services to the government to help uncover Madoff's fraud. If SEC staff lacked the skills, they could have employed Markopoulos or another consultant.

Some argue that the United States needs a unified, stronger financial regulator to prevent such occurrences. Yet major frauds happen in countries such as France, where the regulator is as powerful as can be. Levitt complains that the SEC does not have enough resources. Yet it appears that plenty of resources were in fact spent on the Madoff matter.

The truth is that government agents are subject to the same cognitive weaknesses and biases as market agents and make the same mistakes. Madoff's investors took their cue from one another—as did people in other schemes. Government agents joined in the herding behavior and encouraged the delusion by exonerating Madoff of serious accusations.

Reducing the incidence of fraud requires investors to be more skeptical and alert to early signs of trickery. It requires better awareness of the mental biases we all have, which make people easy marks to smart manipulators. But the popular image of government bureaucrats as wise guardians taking care of the rest of us creates a false sense of security—a cognitive hazard that makes investors more vulnerable. FEE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Do We Need Deposit Insurance?

BY JEFFREY A. MIRON

Before 1914 the U.S. economy experienced frequent bank runs and financial panics. Runs occurred when a shock to one or a few banks—such as crop failure, a major loan default, or a corruption scandal—caused many depositors to attempt to withdraw their money simultaneously. Banks lend out most deposits and hold only a fraction as cash, so widespread demand for withdrawals makes it likely the affected banks will fail. Worse, a run on one bank can increase depositor concerns at nearby banks, leading to contagion and financial panic.

The frequency of bank runs and panics was a crucial reason for creation of the Federal Reserve System in 1914. The idea was that the Fed would provide an "elastic" currency, injecting cash into the economy during periods of high credit or currency demand and withdrawing it in periods of low demand. This policy appeared to work initially, since bank runs disappeared from 1914 through 1928. Runs and panics returned with a vengeance in 1929–1933, however, and the huge number of bank failures contributed significantly to the Great Depression.

In response to the runs and panics during the Depression, the U.S. Congress created federal deposit insurance in 1934. Under this policy the government reimburses the depositors of failed banks. Funding comes from insurance premiums paid by the banks, and from general government funds if necessary. In principle the insurance applies only to deposits below a specified ceiling, but in practice coverage is essentially complete. Depositors can split large accounts across banks, and the FDIC typically covers all deposits.

The public and many economists now take as given that government deposit insurance is good policy. At first glance this conclusion seems warranted. Bank runs have not occurred since 1934, and insured depositors have not lost a dollar in that time. Further inspection, however, suggests that an alternative approach to limiting bank runs might be superior to deposit insurance.

> The problem with deposit insurance is that it generates a moral hazard: When banks know their deposits are insured, they have an incentive to purchase riskier assets.

The problem with deposit insurance is that it generates a moral hazard: When banks know their deposits are insured, they have an incentive to purchase riskier assets. If these assets generate high returns, banks make good profits, while if they fail, deposit insurance cushions the blow. Thus banks assume more risk than warranted by market fundamentals. That is why current regulation tries to limit bank holdings of risky assets while also requiring a minimum degree of capitalization.

In principle the combination of balance-sheet regulation and deposit insurance can both limit runs and prevent excessive risk taking. In practice banks can innovate around much regulation, so they still end up taking more risk than is appropriate. This is precisely

Jeffrey Miron (miron@fas.harvard.edu) is a senior lecturer in Harvard University's economics department.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

what occurred in the run-up to the 2007–2008 financial crisis. By using derivatives, off-balance-sheet vehicles, and "structured finance," banks were able to assume huge risks within the confines of existing regulation. For several years the excessive risk taking generated large profits, but eventually the underlying fundamentals crashed, pushing several large banks to the brink of failure. Widespread failure did not occur, thanks to the Treasury bailout, but the adverse implications for taxpayers were at least as bad as those that failure would have imposed.

In response to these events, many observers have argued that the United States needs more regulation of banks. It is not obvious, however, why additional regulation would be any less subject to manipulation than past regulation. Thus approaches that involve less regulation, not more, are worth considering.

Suspended Convertibility

The crucial regulation in this context is the longstanding regulatory ban on bank suspension of convertibility. This regulation means that when depositors request cash withdrawals, banks are legally obligated to comply. In the absence of legal constraints, banks might offer deposit contracts that allowed them to suspend partially or fully. These contracts would presumably offer different terms from a standard demand deposit. For example, they might require that interest be paid on any suspended balances, or they might specify the length of time a bank could suspend without incurring penalties. They would not, however, commit the bank to always meeting demand withdrawals both immediately and in full.

If banks can suspend convertibility, depositors know that runs merely precipitate suspension. This greatly reduces depositor incentive to panic and run. Allowing banks the right to suspend would probably not eliminate all runs, but it would plausibly limit them to banks that are insolvent rather than merely illiquid.

The question, then, is whether a banking system with less regulation—no prohibition on suspension and no deposit insurance—might work better than current regulation—prohibitions on suspension, combined with deposit insurance and balance-sheet regulation.

The evidence from the pre-1914 era suggests that the regime with less regulation has promise. Banks were not legally allowed to suspend convertibility during this era, but many did so anyway, sometimes with explicit approval of, or even encouragement from, regulators. This did not eliminate runs and panics, but the record suggests that suspension reduced contagion and failure in these episodes. A few panics were associated with substantial declines in output, but many others were short-term and confined to a few cities or parts of the country. Even in cases where recession and panic coincided, some of this correlation no doubt reflects the effect of recession on bank solvency, rather than panics causing recessions. It is plausible, moreover, that suspension would be even more effective in limiting runs and panics if banks were able to experiment with different types of contracts and use suspension without fear of legal jeopardy.

It is plausible that the socially desirable number of runs is not zero; after all, runs discipline banks that take excessive risks.

It is also plausible that the socially desirable number of runs is not zero; after all, runs discipline banks that take excessive risks. In an idealized setting the mere threat of runs might be sufficient to prevent them; actual runs need never occur. In the real world, however, the occasional run is most likely necessary to close down irresponsible or incompetent banks and to remind others to behave.

Both theory and evidence, therefore, suggest that regimes with less regulation deserve as much consideration as those with more regulation. Designing and enforcing regulation is difficult because it complicates incentives and generates unintended consequences, as recent events have shown. Perhaps, therefore, markets are better than regulation at disciplining the banking system. FEB

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Mainstream Macro in an Austrian Nutshell

BY ROGER W. GARRISON

Of all the losses suffered during the current recession, one of the most notable (and well deserved) is the loss in reputation suffered by today's macroeconomics textbooks. J. Bradford DeLong admits as much—even of his own textbook—in a recent lecture on our current financial crisis. While the events that have unfolded over the past year have required some outside-the-box theorizing by mainstream macroeconomists, the economists of the Austrian school can offer a straightforward, fill-in-the-blanks explanation by drawing on the theory first articulated by Ludwig von Mises and then developed by Friedrich A. Hayek.

DeLong blithely rejects the Austrian account. In his lecture delivered January 5 in Singapore, "The Financial Crisis of 2008–2009: Understanding the Causes, Consequences—and Possible Cures," he fabricates a "Marx-Hoover-Hayek axis" (complete with adjoined photos of this unlikely trio) and then offers a brief and ill-informed critique under the heading "The 'Austrian' Story in a Nutshell." (His lecture is available at http://tinyurl.com/c8vxan.)

A true-to-Hayek nutshell version of the Austrian theory is not difficult to produce. The central bank is central to our understanding of the current crisis. The Federal Reserve under the leadership of Alan Greenspan kept interest rates too low during 2003 and 2004 and then ratcheted the rates steeply upward. Time-consuming investments that were initiated while cheap credit made them artificially attractive were then made prohibitively costly to carry through. Macroeconomically, that sequence translates into an Austrian-style boom and bust. The background against which the story unfolded was a long-running, politically motivated sequence of housing policies whose dubious goal was to increase home ownership beyond what mortgage markets themselves would allow. The actual effect of the various policies was to desensitize both lenders and borrowers to the risk of default, causing mortgage markets and hence housing markets to play leading roles in this particular boom-bust episode.

While the events that have unfolded over the past year have required some outside-the-box theorizing by mainstream macroeconomists, the economists of the Austrian school can offer a straightforward, fill-in-the-blanks explanation.

The Austrian theory couldn't be more tailor-made for understanding our current situation. Dealing with the unfortunate consequences of artificially cheap credit, a memorable passage in Mises's *Human Action* (3rd ed., 1966, p. 560) alludes to an overbuilt housing market:

> The whole entrepreneurial class is, as it were, in the position of a master builder whose task it is to erect a building out of a limited supply of building materials. If this man overestimates the quantity of the available supply, he drafts a plan . . .

Contributing Editor Roger Garrison (garriro@auburn.edu), a professor of economics at Auburn University, is the author of Time and Money: The Macroeconomics of Capital Structure. *He thanks Sven Thommesen, Thomas McQuade, and Lawrence White for their help.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> [that cannot be fully executed because] the means at his disposal are not sufficient. He oversizes the groundwork and the foundation and only discovers later in the progress of the construction that he lacks the material needed for the completion of the structure.

The foiled plans in Mises's parable represent the upper turning point of the business cycle. The subsequent compounding of the downturn in the form of a downward spiral into deep recession should not distract attention from the underlying problem of the credit-induced misallocation of resources. The solution must entail, in the first instance, a reallocation of those misallocated resources.

If credit creation by the central bank was the cause of the problem, it is doubtful that still more credit creation is the solution. Similarly, if investment activity was overstimulated by cheap credit, it is doubtful that a stimulus package will hasten recovery. Why, then, isn't there a general recognition of the implausibility of these textbook solutions? And why don't mainstream macroeconomists see the direct applicability of the Austrian theory and the appropriateness of a market solution to the crisis?

In the long run a boom will get you a bust; but in the short run, a boom will get you votes.

Votes Now, Bust Later

For the economist-turned-policymaker, the answer is simple. Policies based on mainstream thinking—cheap credit and stimulus packages—are politically attractive, a circumstance that makes any other theory, particularly as it might apply to the long run, wholly irrelevant. Attempts to rekindle the boom also satisfy the "don't-just-stand-there" criteria for political viability. In the long run a boom will get you a bust; but in the short run, a boom will get you votes. No doubt, many elected officials are oblivious to the first part of this long-run/short-run distinction. And virtually all those not so oblivious see the second part as trumps.

For academic macroeconomists, especially for those trained and employed by top-tier universities, we need a two-part answer to our question. For Part I we must recognize that economists who were trained at Harvard or MIT and hold a faculty position at Berkeley or Princeton have trouble grasping the Austrian theory. They learned their (short-run) macroeconomics and their (long-run) growth theory in two different sets of courses. The capital theory that unites these two subject areas in the Austrian literature was effectively out of play in both sets. In mainstream macro, where business cycles were discussed, capital is assumed to be fixed. In mainstream growth theory, where cyclical movements are assumed away, capital is allowed to grow or to shrink, but it enters the theory as a holistically conceived capital stock.

By contrast, the inherent time dimension in the economy's capital structure makes capital theory a natural common denominator for Austrian macroeconomics and Austrian growth theory. Capital is a sequence of stages of production; its temporal structure is a key macroeconomic variable. Interest rates that reflect people's preferred tradeoff between consuming now and consuming later guide capital creation and allow for sustainable growth. Almost as a corollary, interest rates that are distorted by central-bank policy *mis*guide capital creation and give rise to *un*sustainable growth. The inevitable bust (in the recent and earlier episodes) is a dramatic manifestation of the growth rate's unsustainability.

To mainstream macroeconomists, the mix of cycles, growth, and the temporal allocation of resources makes Austrian theory appear as a disorienting mishmash. The mainstreamers are not won over; they are simply flummoxed. At best, they will try to fit piecemeal the various propositions put forth by the Austrians into an otherwise mainstream theoretical framework. Distortions of the capital structure get translated into unwarranted changes in the size of the capital stock; the plausibility of entrepreneurs being misled by cheap credit gets judged in the light of presumed "rational expectations." The unemployment of labor during the period of capital restructuring gets questioned on the basis of the efficient-market hypothesis. Individually, the pieces don't fit, and so collectively the Austrian propositions are rejected wholesale. (Notice that the Austrian theory is better received by Wall Street analysts

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

trained in finance and attuned to the real economy than by academic macroeconomists.)

Part II of the answer to "Why don't the mainstreamers see the Austrian theory's relevance?" actually deals with a follow-on question. "Why don't they at least make the effort to learn what the Austrian theory is?" After all, economists who study and teach at top-tier universities are intelligent people who *could* learn the Austrian theory. A little reflection suggests that while they surely have the ability, they lack the motivation. For a seasoned member (or even an upstart member) of the Berkeley or Princeton faculty, studying Austrian economics is just not a career-enhancing activity.

Theories that they do know, which include New Keynesian, New Classical, and Real Business Cycle Theory, fail to incorporate capital theory in any meaningful way. And although advertised as "new" and "real," none of these theories have more than a tenuous link to current economic reality. Further, these mainstream theories have now begun to merge together into technically demanding and other-worldly constructions called Dynamic Stochastic General Equilibrium (DSGE) models. For mainstream macroeconomists, the DSGE models are the wave of the future. They are the vehicles for publications and professional advancement. (Googling "Dynamic Stochastic General Equilibrium" yields more than 80,000 results.) Any attention to the Old Austrian theory, then, can only divert their careers in an unrewarding direction.

When the mainstreamers are called on to make a public statement about the current economy or to make a policy recommendation, they find their DSGE models wholly unserviceable. And so they simply fall back on the simplest, principles-level version of these complex formal models—which, not surprisingly, is the Old Keynesian theory. Their policy positions are based on the decades-old textbook construction in which earning and spending are locked into a spiral-prone circular flow—and in which countering a downward spiral requires a deficit-financed stimulus package.

Economists who study and teach at top-tier universities are intelligent people who could learn the Austrian theory. While they surely have the ability, they lack the motivation: Studying Austrian economics is just not a career-enhancing activity.

Austrian Theory in a Mainstream Straitjacket

The short final section of DeLong's Singapore lecture, his nutshell rendition of the "Austrian Story," presents us with a particularly significant case study of the mainstream perspective on Austrian theory. During the several months before his January lecture, DeLong had multiple encounters with the Austrian theory as applied to our current financial crises. The Cato Institute's 26th Annual Monetary Conference (held in November 2008) was titled "Lessons from the Subprime Crisis." Among the dozen or so papers presented at that conference, the Austrian school was well represented. Although DeLong was not a conference participant, he reacted on December 8 to an online version of Lawrence H. White's conference paper, "What Really Happened," with a critique titled, "Liquidity, Default, Risk." White responded on December 10 with an insightful defense of the Austrian theory. This exchange of ideas was then followed by still more contributions to "The Conversation" stemming from the White paper and including four additional comments by White. (The DeLong-White exchange is accessible through www.catounbound.org, and all the conference papers appear in the winter issue of the *Cato Journal*.)

So what effect did this virtual immersion in Austrian theory have on DeLong's understanding? The answer: little or none. Although his January "nutshell" is just too small to contain much understanding at all, it does contain evidence of the continuing fundamental misunderstandings typical of mainstream critiques.

DeLong's explanation of the Austrian view makes reference only to "the economy's capital stock"—that phrase from mainstream macroeconomics that treats capital holistically. Willful or not, DeLong has distorted

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the Austrian theory by force-fitting it into his mainstream macroeconomic framework. And in DeLong's rendition of the Austrian view, we see that the "overinvestment" that characterized the boom implies that "the economy's capital stock needed to shrink." A two-panel diagram showing "boom" and "crash" is used to depict the sequence of overinvestment and shrinkage. The demand for risky assets first rotates up producing the boom and then rotates back down precipitating the crash. The Austrians themselves would claim, instead, that the *malinvestment* (Mises's term) that characterizes the boom implies the need for a *capital restructuring*. In other words, the allocation of resources *within* the capital structure has to be brought in line with post-boom market rates of interest. This restructuring takes some time and is best achieved, in the Austrians' view, by the market itself.

The allocation of resources within the capital structure has to be brought in line with post-boom market rates of interest. This restructuring takes some time and is best achieved, in the Austrians' view, by the market itself.

From the Time Dimension to the Moral Dimension

Turning a blind eye to the notions of malinvestment and capital restructuring, DeLong quickly shifts ground from economics to ideology and from F. A. Hayek to Herbert Hoover. (We will take DeLong's inclusion of Marx in his discussion as pure hyperbole.) DeLong takes the Austrians' call for a market solution (capital restructuring) rather than a government solution (rekindling the boom) as justification for denigrating the Austrians as "liquidationists," a label popularized by DeLong himself in earlier articles and associated in his own thinking with Hayek, Hoover, and Hoover's treasury secretary, Andrew Mellon. The specific recommendations that Mellon supposedly offered for dealing with the 1929 crash and its aftermath are, by themselves, almost enough to call this association into question:

> Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate. It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people.

Significantly, DeLong's broad-brush use of the term "liquidationism" was criticized by White in a 2008 paper titled, "Did Hayek and Robbins Deepen the Great Depression?" (*Journal of Money Credit and Banking*, June issue). In arguing the absence of a Hayek-Hoover connection, White is convincing on two key points. First, sheer chronology precludes the possibility of Hayek having a timely influence on Mellon and/or Hoover. Hayek's first English-language statement of the Austrian theory was not published until 1931. Besides, a much more obvious basis for Mellon's thinking was the fallacious Real Bills Doctrine, which was written into the legislation that created the Federal Reserve System. Second, there is no evidence that the above quoted passage can actually be attributed to Mellon. It comes from Hoover's *Memoirs* (1952) and reads like a caricatured rendition of Mellon's views—a rendition that sets the stage for Hoover's *rejection* of those views.

For the Austrians the liquidation of malinvestments is essential to the economy's recovery. Resources need to be reallocated. Hence, any government spending program that serves to rekindle the housing boom or even to keep resources from leaving the housing industry is counterproductive. It locks in the misallocated resources. Similarly, restoring macroeconomic health requires the liquidation of many other long-term or early-stage investments whose expected profitability depended on artificially low borrowing costs.

This needed liquidation does not imply that "a panic would be not altogether a bad thing," a judgment that DeLong also attributes—via Hoover—to Mellon. What Mellon (or Hoover) called a panic, Hayek called a "sec-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ondary contraction," meaning a self-reinforcing spiraling downward of economic activity that causes the recession to be deeper and/or longer-lasting than is implied by the needed liquidation of the malinvestment. Hayek argued, in effect, that the "ideal" policy would be one that allows the needed liquidation to proceed at market speed while the monetary authority curbs the secondary contraction (the panic) by maintaining a constant flow of spending. In terms of the equation of exchange (MV=PQ), Hayek argued that the ideal policy was to keep MV—and hence PQ—constant by increasing the money supply (M) just enough to offset declines in money's velocity of circulation (V). Hayek used the word "ideal" in recognition that the monetary authority may lack both the technical ability and the political will actually to implement that policy. (It would lack the technical ability because it would have no way of getting timely information on the changes in money's circulation velocity; it would lack the political will because pulling money out of the economy when eventually the velocity begins to rise is a politically unpopular thing to do.) But in any case, Hayek and the Austrians generally regarded the secondary deflation as "altogether a bad thing." (In Hayek's later writings, he favored a decentralized monetary system—in which market forces, rather than an ideally managed central bank, would govern changes in the money supply.)

Mellon is charged (by DeLong and many others) with having a "moral objection" to curbing even the secondary contraction. This moral dimension to Mellon's supposed liquidationism tends to get imputed to the Austrian view as well. DeLong quotes Martin Wolf (*Financial Times*, Dec. 23, 2008) at some length on this point. Wolf insisted (with a bow to Keynes) that "we should approach an economic system not as a morality play but as a technical challenge."

It is worth noting here that characterizing the Austrian Story as a morality play is not original with Wolf—and certainly not with DeLong. Most likely, this particular putdown comes form Paul Krugman, whose understanding of Austrian theory rivals DeLong's. Krugman's introduction to the 2006 printing of John Maynard Keynes's *General Theory of Employment, Interest, and Money* contains the following passage:

> Keynes's limitation of the question [about a depressed economy] was powerfully liberating. Rather than getting bogged down in an attempt to explain the dynamics of the business cycle—a subject that remains contentious to this day—Keynes focused on a question that could be answered. And that was also the question that most needed an answer: Given that overall demand is depressed (never mind why), how can we create more employment?
>
> A side benefit of this simplification was that it freed Keynes and the rest of us from the seductive but surely false notion of the business cycle as morality play, of an economic slump as a necessary purgative after the excesses of a boom. By analyzing how the economy stays depressed, rather than trying to explain how it became depressed in the first place, Keynes helped bury the notion that there's something redemptive about economic suffering.

The Austrian Story is not a morality play. It is a piece of economic analysis. Nor is it just some variation on a theme that can be understood in terms of the analytical framework of mainstream macroeconomics.

The Austrian Story is not a morality play. It is a piece of economic analysis. Nor is it just some variation on a theme that can be understood in terms of the analytical framework of mainstream macroeconomics. Rather, Mises and Hayek offered a more encompassing macroeconomic framework, one that illuminates the market mechanisms that allocate resources among the temporally defined stages of production and traces the intertemporal misallocation of those resources to misguided or politically motivated policies of the central bank.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

It is important to see that the whole focus of mainstream macroeconomics, and certainly DeLong's focus, is fundamentally different from the focus of the Austrian economists. The difference, fully recognized by White in his response to DeLong, is captured in Krugman's introduction to Keynes's *General Theory*. Keynes suggested remedies for the ongoing depression without bothering himself about just how the economy came to be depressed in the first place. Throughout the Singapore lecture, DeLong, following Keynes, argues as if it is simply in the nature of capitalism that there are waves of speculation followed by a collective quest for liquidity—for more liquidity than can be readily accommodated in a modern capital-intensive economy. The central bank comes into play only to counter the economy's wealth-destroying gyrations.

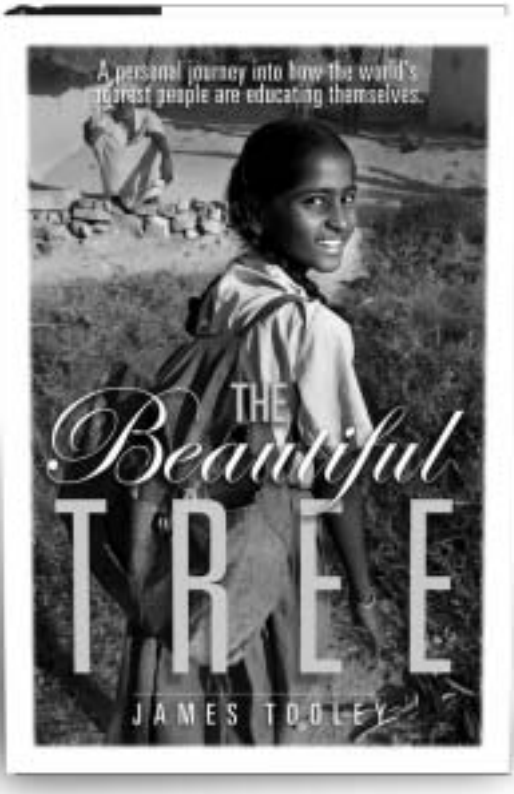
Hayek focused on the dynamics of the preceding boom, thinking that the question of how the economy came to be depressed was the most interesting and challenging question, and believing that a satisfactory answer to that question was a strict prerequisite to figuring out how (and how not) to deal with the depressed economy.

An Austrian Perspective on Suffering

There is nothing "redemptive about economic suffering." Krugman, Wolfe, and DeLong are right about that. There is also nothing redemptive about the suffering of the Austrian school in the wake of ill-informed criticism. But the Austrian ideas will continue to suffer as long as mainstream macro continues to develop along its current path. And the suffering of the economy will continue—and intensify—as long as policymakers, following their political instincts and enjoying the support of mainstream economists, opt for ever-bigger stimulus packages to be financed by mushrooming debt. FEE

NEW BOOK FROM THE CATO INSTITUTE

"The author's engaging style transforms what could have been a dry if startling research report into a moving account of how poor parents struggle against great odds to provide a rich educational experience to their children."
—*PUBLISHERS WEEKLY*



The Beautiful Tree: A personal journey into how the world's poorest people are educating themselves
BY JAMES TOOLEY

An inspiring journey into the lives of families and teachers in the poorest communities of India, Africa and China who have successfully created their own private schools in response to failed public education.

HARDBACK : $19.95 • E-BOOK: $11.00

Buy your copy at bookstores nationwide, call 800-767-1241, or visit Cato.org.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Shame of Medicine: The Case of Alan Turing

BY THOMAS SZASZ

Alan Mathison Turing (1912–1954) was one of the legendary geniuses of the twentieth century. The only child of a middle-class English family, the Cambridge-educated Turing played a crucial role in breaking the German Enigma code during World War II, an achievement often credited with saving Britain from defeat in the dark days of 1941. Because of the secrecy surrounding the British code-breaking effort, for a long time only a few colleagues and high-ranking politicians were aware of Turing's towering contribution to science and the war effort.

Turing was a mathematician, cryptographer, and pioneering computer scientist. He was good-looking, athletic, eccentric, and openly homosexual. In 1935, backed by John Maynard Keynes, Turing was elected a Fellow of King's College, a remarkable achievement for so young a man. In 1936 he published a paper that immediately became a classic in mathematics and earned him an an invitation from John von Neumann to continue his studies at Princeton University. In 1938, having been awarded a Ph.D. in mathematics, Turing returned to Cambridge and was soon working at Bletchley Park, the famous British code-breaking "factory." When the war ended, Turing moved to Manchester where the university created a special readership in the theory of computing for him.

In 1951 Turing began a homosexual relationship with a working-class youth. Returning home one evening, he found that his house had been burglarized. He reported the crime to the police and communicated his suspicion that the culprit was an associate of his gay friend. He confessed to his homosexual affair and was charged with "gross indecency," a crime then punishable by a maximum of two years' imprisonment. The judge, taking into account Turing's intellectual distinction and social position, sentenced him to probation, "on the condition that he submit for treatment by a duly qualified medical practitioner." In April 1952 he wrote to a friend, "I am both bound over for a year and obliged to take this organo-therapy for the same period. It is supposed to reduce sexual urge whilst it goes on, but one is supposed to return to normal when it is over. I hope they're right." Turing was never the same again. His body became feminized. He grew breasts.

Fatal Treatment for a Fictitious Disease

On June 8, 1954, Turing was found dead by his housekeeper, a partly eaten apple laced with cyanide next to his bed. At the inquest, the coroner ruled his death a suicide. Neither his homosexuality nor his psychiatric treatment was mentioned. The coroner said, "I am forced to the conclusion that this was a deliberate act. In a man of this type, one never knows what his mental processes are going to do next." The verdict was "suicide while the balance of his mind was disturbed." Even in death, psychiatry and the state stigmatized Turing as mad. The posthumous diagnosis of suicide as mental illness is the ritual degradation ceremony of our therapeutic age, much as the posthumous burning of the heretic's corpse was the ritual degradation ceremony of an earlier theological age.

Even in death, psychiatry and the state stigmatized Turing as mad.

No one in Turing's circle, himself included, was able or willing to transcend the psychiatric zeitgeist: Homoerotic behavior and self-determined death are self-evident symptoms of mental illness, it argued, requiring and justifying coercive medical-psychiatric treatment.

Thomas Szasz (tszasz@aol.com) is professor of psychiatry emeritus at SUNY Upstate Medical University in Syracuse. His latest books, both from Syracuse University Press, are The Medicalization of Everyday Life: Selected Essays *and* Psychiatry: The Science of Lies.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Turing's psychiatrist, Dr. Frank M. Greenbaum, vehemently rejected the coroner's diagnosis, though not by contesting the claims that engaging in homosexual conduct and self-killing are evidence of diseases curable by doctors. "There is not the slightest doubt to me that Alan died by an accident," declared Greenbaum.

In 1967 the UK decriminalized homosexuality. Overnight it ceased to be a disease in England but not the United States, where for six more years it remained both a crime and a "treatable disease."

Turing's biographer, Andrew Hodges, notes that Turing did not consider his homosexuality a disease, a crime, or a shameful condition. He suggests that Turing opted for medical treatment rather than a brief period of imprisonment because he feared that a criminal conviction would be fatal for his career. Countless of Turing's gay contemporaries at Cambridge and in London—Wittgenstein, Keynes, Lytton Strachey, many of the Apostles and Bloomsburys—sensibly stayed away from psychiatrists. Many famous people—Gandhi, Russell, and Nehru—spent time in prison, though, and went on to do memorable work. This is not true for people imprisoned in mental hospitals. After the psychiatric degraders finish their job, the "patient" is dead—if not biologically then socially.

After the psychiatric degraders finish their job, the "patient" is dead—if not biologically then socially.

Psychiatric destruction often begins with psychiatric self-destruction, the denominated patient believing the psychiatrist's self-deceptions about nonexisting diseases and their damaging treatments. "The worst enemy of truth and freedom in our society," declared Henrik Ibsen (1828–1906), "is the compact majority. Yes, the damned, compact, liberal majority." Let us not forget that the power of science is limited to informing and misinforming. It does not have the power to coerce. In contrast, power to coerce is the very essence of psychiatric pseudoscience allied with the state. Psychiatrists regularly characterize their power to coerce as "suicide prevention." The opposite is often the case.

The original function of psychiatry—which is approximately 300 years old—was penological: The psychiatrist stigmatized persons as "mad," deprived them of liberty, and assaulted them with chemical and physical interventions. A little more than 100 years ago individuals began to seek psychiatric help for their own problems. As a result, many people who entrusted themselves to the care of psychiatrists became entrapped in the machinery of punitive mad-doctoring, dramatically portrayed in Ken Kesey's best-selling novel, *One Flew Over the Cuckoo's Nest*, and the film based on it. The recent film *Changeling* presents a real-life example.

So does Alan Turing's psychiatric undoing.

Psychiatry: Trap, Not Treatment

The identification of psychiatry with medical healing and humane helpfulness is factually false and morally deceptive, concealing an existential trap with untold-of potentialities for injury and death for the entrapped. More successfully than ever, the modern "biological" psychiatrist misrepresents his profession as based on biological science and medical discovery, while more than ever it is based on pseudoscience and therapeutic deception.

The persecution of homosexuals is paradigmatic of the history of psychiatry's monumental blunders and brutalities and of its policy of never acknowledging nor apologizing for them. Instead, organized psychiatry intensifies the celebration of its founding quack, Benjamin Rush (1746–1813). Declared Rush, "I have selected those two symptoms [murder and theft] of this disease [crime] (for they are not vices) from its other morbid effects, in order to rescue persons affected with them from the arm of the law, and render them the subjects of the kind and lenient hand of medicine." What did Rush mean when he spoke of medical kindness and lenience? Lamenting the "excess of the passion for liberty inflamed by the successful issue of the [Revolutionary] war," he explained, "Were we to live our lives over again and engage in the same benevolent enterprise, our means should not be reasoning but bleeding, purging, low diet, and the tranquilizing chair." Psychiatry—glorifying the use of coercion as cure—is the shame of medicine. FEE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Global Warming Revisited

BY MICHAEL HEBERLING

In the May 2001 *Freeman* I published "Unprecedented Global Warming?" (http://tinyurl.com/bkuvyn), which noted that climate change (global warming and global cooling) is a continuing phenomenon and that what we've witnessed in the last 25 years is "by no means unprecedented." The Medieval Warm Period (800-1300), which took place without SUVs, power plants, or factories, was warmer than it is today. Crippling our economy to solve a minor (or nonexistent) future problem struck me as a serious mistake.

That article was tantamount to heresy among those who devoutly believe in anthropogenic (manmade) global warming. A physics professor responded, "Heberling's commentary is the latest in a long list of junk-science commentaries about climate change. Heberling, who is not a scientist, but rather the president of a small business school, repeats several old and misleading ideas."

Of course, Al Gore, the Nobel laureate who has made global warming his cause, is not a scientist. He has a B.A. in government. For the record, I have a B.S. from Cornell University, where I took courses in physics, chemistry, geology, and meteorology. However, this makes little difference because my sin was to downplay the severity of global warming, and too many people and organizations are tied financially to the "crisis."

As MIT atmospheric physicist Richard Lindzen puts it, "Ambiguous scientific statements about climate are hyped by those with a vested interest in alarm, thus raising the political stakes for policymakers who provide funds for more science to feed more alarm to increase the political stakes. Indeed, the success of climate alarmism can be counted in the increased federal spending on climate research from a few hundred million dollars pre-1990 to $1.7 billion today."

The Government Accountability Office says that for over 15 years the federal government has funded programs to study the earth's climate and to reduce emissions of carbon dioxide and other greenhouse gases linked to climate change. A review of the number of government agencies and the amount of government money devoted to "climate change" is staggering. Nine of the 15 cabinet-level departments receive significant funding for climate-change activities. A 2007 White House press release boasted, "The President has devoted $37 billion to climate-change-related activities since 2001." The U.S. Global Change Research Program,

Michael Heberling (mheber01@baker.edu) is president of the Baker College Center for Graduate Studies in Flint, Michigan. The temperature was 9 below zero when he wrote this.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

which has 13 federal agency participants, has made the largest scientific investment in climate change research at $20 billion over a 13-year period. The federal organizations with the largest budgets devoted to climate-change activities include NASA, the National Science Foundation, the Department of Energy, and the National Oceanic and Atmospheric Administration.

For those who embrace big government and centralized planning, the global-warming crisis has been a godsend. Under the mantra "preventing global warming," government has greatly expanded into our daily lives. Mandates have superseded consumer choice in the areas of energy, transportation, and appliances. For example, when compared to the traditional light bulb, the new government-mandated compact fluorescent light bulb is far more expensive, loaded with mercury, and takes time to illuminate. To compensate for this delay, consumers leave the lights on. How does this help the environment or curtail global warming?

For those who embrace big government and centralized planning, the global warming crisis has been a godsend. Under the mantra "preventing global warming," government has greatly expanded into our daily lives.

And the Horse You Rode In On

Given the billions of federal dollars at stake, it is not surprising that there would be resistance to any free flow of ideas that might question the crisis. If we don't have a crisis, then we won't need the government to ride in on a white horse throwing billions around to save us. It therefore becomes imperative to squelch or marginalize dissent. Name-calling, shooting the messenger, and the use of such show-stopper statements as "We have consensus" and "The debate is over" usually do the trick.

In the name-calling category, we find the following epithets: "climate-change denier," "flat-earth advocates," and "tools or stooges of Big Oil."

Jeff Kueter of the Marshall Institute says that scientists who challenge global warming "are quickly labeled as having received money from the petroleum industry. The media consider their findings and their opinions to somehow be tainted because they've got a financial relationship." Why is there never any suspicion in the other direction, when a researcher has a financial relationship with the government and its agenda for more regulations, more mandates, a carbon tax, and the nationalization of the energy sector? Why don't the media ever call such a researcher a "tool of big government"?

What about the consensus we hear so much about? Gregg Easterbrook expresses the mainstream sentiment: "The consensus of the scientific community has shifted from skepticism to near-unanimous acceptance."

The late author Michael Crichton had this response:

> I regard consensus science as an extremely pernicious development that ought to be stopped cold in its tracks. Historically, the claim of consensus has been the first refuge of scoundrels; it is a way to avoid debate by claiming that the matter is already settled. Whenever you hear the consensus of scientists agrees on something or other, reach for your wallet, because you're being had.
>
> Let's be clear: the work of science has nothing whatever to do with consensus. Consensus is the business of politics. Science, on the contrary, requires only one investigator who happens to be right, which means that he or she has results that are verifiable by reference to the real world. In science consensus is irrelevant. What is relevant is reproducible results. The greatest scientists in history are great precisely because they broke with the consensus.
>
> There is no such thing as consensus science. If it's consensus, it isn't science. If it's science, it isn't consensus. Period.

One of the biggest tragedies of consensus science is the chilling effect it has on those who fall outside of this consensus. "Scientists who dissent from the alarmism have seen their grant funds disappear,"

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Lindzen says. "It's my belief that many scientists have been cowed not merely by money but by fear. Alarm rather than genuine curiosity, it appears, is essential to maintaining funding. And only the most senior scientists today can stand up against this alarmist gale and defy the iron triangle of climate scientists, advocates and policy makers."

Threat Level Whatever

The problem with public policy based on alarmism is that it's hard to sustain. There are three reasons for this. The first is overselling the crisis. The general public has become numb and cynical about the endless barrage of ills all tied to global warming. (Even the disappearance of the Loch Ness Monster has been attributed to it.)

The second reason is clear and convincing evidence to the contrary. This is what did in the last climate-change crisis. A *New York Times* headline on May 21, 1975 blared: "Scientists Ponder Why World's Climate is Changing: A Major Cooling Widely Considered to be Inevitable." But it was hard to continue the hype about *global cooling* when it got hot outside. While the current global warming debate may be over, Mother Nature is, unfortunately, not cooperating. Contrary to the infallible computer climate-model predictions (which I call high-tech crystal balls), global temperatures peaked ten years ago, in 1998. There was no appreciable temperature increase for the next eight years. However, for the last two years the temperatures have actually fallen. The past two winters have been brutally cold. This painful realization may help to explain the sense of urgency in Congress to pass climate-change legislation—right now! Rep. Henry Waxman said at the opening of the 2009 congressional hearings on global warming that he plans to move "quickly and decisively" to push through climate legislation before Memorial Day (Or does he mean before it gets even colder?)

Consensus science shut down Galileo.
commons.wikipedia.org

The final reason is that the alarmist crisis gets run over by a real crisis. With the financial turmoil, the housing crisis, the stock-market crash, and rising unemployment, it is hard to get excited about global warming. In the January Pew Public Survey Poll, global warming came in 20th out of 20 on the list of Top Priorities for America. The top five were: the economy, jobs, terrorism, Social Security, and education.

The global-warming crisis was tailor-made to simultaneously advance the agendas of the environmentalists, big government, and those who vilify the oil industry and business in general. There is far too much at stake to have this crisis die peacefully. As a result, there will be extensive efforts to keep it alive. For starters, the phrase "global warming" is being used less frequently (if at all). It's been replaced with the nebulous, but error-free, "climate change." Given that the earth's climate has been changing for millions of years, "climate change" covers all bases (both warming and cooling). The problem with this approach, however, is that the public won't buy it. It is hard to get excited about the dangers of "climate change."

Be prepared for more talk about "energy security" and "energy efficiency." This will lead to more government-mandated products and less consumer choice. There will still be a push for a carbon tax—or a cap-and-trade scheme, President Obama's preferred policy. However, without the global-warming hysteria, this will be a harder sell.

Carbon dioxide will continue to be demonized as a "greenhouse gas." Even though it is harmless to humans and is needed by all plant life, it will be called a toxic pollutant by the media, militant environmentalists, and politicians. Yet carbon dioxide makes up less than 4 percent of all greenhouse gases. Water vapor accounts for 95 percent.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Shut Off the Alarmists

What's to be done? First, we should abandon all efforts and discussions related to cap-and-trade, carbon offsets, carbon footprints, and carbon taxes, which would never go away if implemented and won't measurably change the temperature.

Second, we should stop government from funding climate change science. As John Tierney of the *New York Times* writes: "[Government] officials running the agencies have their own agendas . . . which can be [met] by supporting research demonstrating that there's a terrible problem for the agency to solve." Climatologist Patrick Michaels states, "[N]o one ever received a major research grant by stating that his or her particular issue might not be a problem after all."

Third, we should demand that lobbyists for expanded government power disclose their financial backers.

Finally, we need to accept that climate change, both global warming and global cooling, will continue. Ironically, of the two we should wish for warming. Mankind has prospered in warming periods because agricultural production increased at higher latitudes and elevations. The opposite was true with global cooling. I'll take global warming over another Ice Age. My request to Washington: Please don't pass legislation to make Michigan any colder than it already is. FEE

BE A GREAT ECONOMIC THINKER

Dr. Mark Skousen tells the dramatic story of the great economic thinkers, updated for 2009, with in-depth and "tell all" biographies on Adam Smith, the Austrian and Chicago schools.....a devastating critique of Karl Marx's theories of capitalism (this chapter alone has converted many Marxists into free-market advocates)....two chapters on Keynes and Keynesian economics, what one economist has called "the most devastating critique of Keynesian economics ever written." Over 100 illustrations, portraits, and photographs, provocative sidebars, humorous anecdotes, even musical selections reflecting the spirit of each major economist.

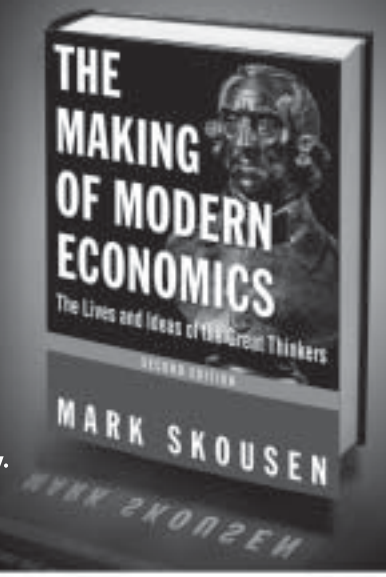
"I champion Skousen's new book to everyone. I keep it by my bedside and refer to it often. An absolutely ideal gift for college students."
--William F. Buckley, Jr., National Review

"Mark Skousen has emerged as one of the clearest writers on all matters economic today, the next Milton Friedman." --Michael Shermer, Scientific American

"Lively and accurate, a sure bestseller. Skousen is an able, imaginative and energetic economist." -- Milton Friedman, Hoover Institution

"I couldn't put it down! The musical accompaniments for each chapter are a wonderful touch. Humor permeates the book and makes it accessible like no other history. It will set the standard."--Steven Kates, chief economist, Australian Chamber of Commerce

"My students love The Making of Modern Economics! Mark Skousen makes the history of economics come alive like no other textbook." --Roger W. Garrison, Auburn University.



Call 1-800-211-7661.

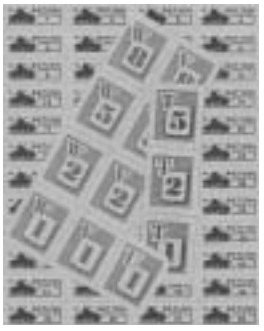
The Making of Modern Economics (2nd edition) is a 528-page quality paperback available from Amazon.com, or directly from the author at a special discount. The book normally sells for $42.95, but you pay only $24.95, plus $4 postage & handling. (Hardback copies are also available for only $49.95, plus $4 P&H.) Call, or send check to Eagle Publishing, One Mass. Ave. NW, Washington, DC 20001.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Two-Price System: U.S. Rationing During World War II

BY ROBERT HIGGS

As the United States mobilized for war after mid-1940, the government's demands for munitions and related resources began to put pressure on certain markets, and soon prices began to rise. In 1941 they rose faster: from December 1940 to December 1941, the producer price index increased by 17 percent, the consumer price index by 10 percent. In response the government imposed a growing number of selective price controls, enforced by the Office of Price Administration and Civilian Supply, an agency created by executive order on April 11, 1941. The Emergency Price Control Act of January 30, 1942, provided a statutory basis for a successor agency, the Office of Price Administration (OPA). Strengthened by later legislation and executive orders, the OPA eventually administered a price-control system that encompassed almost all civilian goods and services. Thus from early in 1942 until late in 1946, the OPA endeavored to control prices by administrative decree.



Ration coupons.
Ames Historical Society

As the government's war outlays rose steeply and the incomes of a growing legion of war-industry workers rose along with them, consumer demand for goods and services increased rapidly. If prices had been unregulated, this increasing demand would have pushed prices ever higher, especially given that the resources available for augmenting the supply of civilian goods were being depleted by the government's buildup of the armed forces and the war industries. But because price controls eventually kept the legal prices of civilian goods and services from rising substantially, civilian markets became subject to excess demand and the available goods had to be rationed by nonprice means, such as first-come-first-served transactions and discrimination according to race, sex, and friendship.

Supplies of some goods—including rubber products, sugar, and coffee—had been diminished by Japanese capture of supply sources (Malayan rubber plantations) or by naval warfare or scarcity of shipping services (German U-boats sank many U.S. merchant ships early in 1942). Government claims on rubber and tin cut further into supply, creating extreme excess demand for these goods. Shortages arose for automobile, truck, and tractor tires as well as for sugar and coffee—goods obtained largely from Latin American sources. Canned foods grew much scarcer because imports of Bolivian tin, used to coat the inside of cans, had been diminished by the increased shortage of shipping services. Therefore, many consumers could not obtain certain goods they normally consumed, and workers and housewives grew restive.

To curb the growing dissatisfaction, the OPA subjected scores of basic goods and services (which accounted for about one-seventh of all consumption spending) to rationing, creating a two-price system. To purchase a rationed good legally, the buyer had to surrender to the seller not only the (controlled) money price but also a stipulated amount of ration coupons or stamps ("points"). The system quickly became complex, and it remained subject to periodic changes and to a variety of exemptions for certain classes of buyers and goods. The table on the next page shows the program's coverage and duration.

Rationing greatly increased the transaction costs of shopping for ordinary goods. Historian Richard R. Lingeman writes in *Don't You Know There's a War On?* (1970):

Robert Higgs (rhiggs@independent.org) is senior fellow at the Independent Institute (www.independent.org), editor of The Independent Review, *and author of* Neither Liberty nor Safety: Fear, Ideology, and the Growth of Government *(Independent Institute).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> For the housewife, the rationing system meant the mastery of a constantly changing system of point values in the papers; while shopping, she kept one eye peeled on the monetary price and the other on the little red numerals posted on the shelf below products indicating their point price. She practiced double budgeting: money and points. She had to keep track of which stamps were valid during a certain time period, which were outdated, and what they might buy.

Mastering the prevailing stamp regime was only half the battle. Lingeman writes, "Housewives trekked from one market to another seeking meat for tonight's supper; some days they were lucky to get frankfurters." All sorts of expedients cropped up in response to these shortages. Lingeman continues, "So in demand were [frankfurters] that OPA told meat-packers to stretch them with various fillers such as soybeans, potatoes or cracker meal." Coffee also suffered the addition of various fillers. Even gasoline was adulterated, with a substance known as Lubrigas. Even so, gasoline—along with sugar, butter, beef, pork, and bacon—at times disappeared from local markets. Lingeman concludes that "compared to the average level of peacetime living that most [Americans] were used to, they underwent hardships." So much for "wartime prosperity."

Rationed products	Effective dates
Sugar	May 1942 to June 1947
Coffee	November 1942 to July 1943
Processed foods	March 1943 to August 1945
Meats, fats, canned fish, cheese, and canned milk	March 1943 to November 1945
Rubber footwear (six heavy-duty types)	October 1942 to September 1945
Shoes	February 1943 to October 1945
Fuel oil and kerosene	October 1942 to August 1945
Stoves	December 1942 to August 1945
Solid fuels (Pacific Northwest only)	September 1943 to August 1945
Tires	January 1942 to December 1945
Automobiles	February 1942 to October 1945
Gasoline (initially East Coast only)	May 1942 to August 1945
Bicycles	July 1942 to September 1944
Typewriters	March 1942 to April 1944

Making Crime Pay

Price controls and rationing created opportunities, however, for people willing to break the law. Active black markets developed all over the country. Substantial proportions of all transactions in some goods—especially beef and gasoline—occurred illegally. Housewives routinely bent the rules by trading, giving away, or selling ration stamps, which the law forbade. Mobsters entered the scene en masse, stealing ration coupons from OPA offices and reselling them, counterfeiting ration coupons and selling them, and hijacking trucks and selling their cargos without collecting ration stamps. Cattle rustling made a comeback.

Between February 11, 1941, and May 31, 1947, the OPA instituted 259,966 sanctions of various sorts. "One in fifteen businesses—wholesale, retail, service and so on—was charged with illicit transactions," and "one in five of all establishments in the country received some kind of warning short of criminal prosecution," according to Lingeman. Of course, many violations escaped notice, even though the OPA enforcement corps included at various times 2,000-5,000 investigators, working under 500-1,000 attorneys, and many thousands of part-time volunteers. As economic historian Hugh Rockoff notes, "[B]lack-market activities do not leave good statistical records and any estimate must be viewed as having a wide margin of potential error." Yet he also remarks that "the appearance of deterioration and related evasive schemes in relatively homogeneous commodities," such as fuel oil, coal, and gasoline, "testifies to the ubiquity of evasion."

After an extensive study of wartime price controls during World War II, Rockoff concludes in his book *Drastic Measures* (1984): "The modern state has the power to control prices even in the face of a vast expansion of aggregate demand relative to output, but it can do so only through a drastic regimentation of economic life." Rationing was an important part of that regimentation. FEE

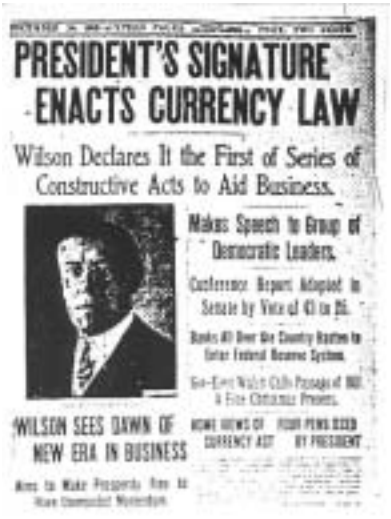
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A Crisis of Political Economy

BY CHRIS MATTHEW SCIABARRA

One of the things that I have long admired about Austrian-school theorists, such as Ludwig von Mises, F. A. Hayek, and Murray Rothbard, is their understanding of political economy, a concept that conveys, by its very coupling, the inextricable tie between the political and the economic.

When Austrian-school theorists have examined the dynamics of market exchange, they have stressed the importance not only of the larger political context within which such exchanges take place, but also the ways in which politics influences and molds the shape and character of those exchanges. Indeed, with regard to financial institutions in particular, they have placed the state at the center of their economic theories on money and credit.


PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

Wilson Declares It the First of Series of Constructive Acts to Aid Business.

Makes Speech to Group of Democratic Leaders.

WILSON SEES DAWN OF NEW ERA IN BUSINESS

Establishing the Federal Reserve cartelized banking and created a mutually reinforcing state-banking nexus.

Throughout the modern history of the system that most people call "capitalism," banking institutions have had such a profoundly intimate relationship to the state that one can only refer to it as a "state-banking nexus." As I point out in *Total Freedom: Toward a Dialectical Libertarianism*:

> A nexus is, by definition, a dialectical unity of mutual implication. Aristotle . . . stresses that "the nexus must be reciprocal . . . [T]he necessary occurrence of this involves the necessary occurrence of something prior; and conversely . . . given the prior, it is also necessary for the posterior to come-to-be." For Aristotle, this constitutes a symbiotic "circular movement." As such, the benefits that are absorbed by the state-banking nexus are mutually reinforcing. Each institution becomes both a precondition and effect of the other.

The current state and the current banking sector require each other. They are so reciprocally intertwined that each is an extension of the other.

Remember this the next time somebody tells you, as *New York Times* columnist Bob Herbert did, that "free market madmen" caused the current financial crisis that is threatening to undermine the global economy. There is no free market. There is no "laissez-faire capitalism." The government has been deeply involved in setting the parameters for market relations for eons; in fact, genuine "laissez-faire capitalism" has never existed. Yes, trade may have been less regulated in the nineteenth century, but not even the so-called Gilded Age featured "unfettered" markets.

One reason I have come to dislike the term "capitalism" is that, historically, it has never manifested fully its so-called "unknown ideals." Real, actual, historically specific "capitalism" has always entailed the intervention of the state. And that inter-

Chris Matthew Sciabarra (chris.sciabarra@nyu.edu) is a visiting scholar in New York University's politics department and the author of Marx, Hayek, and Utopia, Ayn Rand: The Russian Radical, *and* Total Freedom: Toward a Dialectical Libertarianism.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

vention has always had a class character; that is, the actions of the state have always benefited and must always benefit some groups at the expense of others.

No Neutral Government Action

Mises understood this when he constructed his theory of money and credit. For Mises, there is no such thing as a "neutral" government action, just as surely as there is no such thing as "neutral" money. As he pointed out in *The Theory of Money and Credit* and other works, "Changes in the quantity of money and in the demand for money . . . never occur for all individuals at the same time and to the same degree and they therefore never affect their judgments of value to the same extent and at the same time." He traced how, with the erosion of a gold standard, an inflation of the money supply would diffuse slowly throughout the economy, benefiting those, such as banks and certain capital-intensive industries, who were among the early recipients of the new money.

One reason the gold standard was abandoned is its incompatibility with a structural policy of inflation and with a system heavily dependent on government intervention. (It should be pointed out that a free-banking system need not necessarily entail a 100 percent reserve gold standard, but I leave this discussion for another day.) The profiteers of systematic inflation are not difficult to pinpoint. Taking their lead from Mises, Hayek, and Rothbard and such New Left revisionist historians as Gabriel Kolko and James Weistein, Walter Grinder and John Hagel III point out:

> Historically, state intervention in the banking system has been one of the earliest forms of intervention in the market system. In the U.S., this intervention initially involved sporadic measures, both at the federal and state level, which generated inflationary distortion in the monetary supply and cyclical disruptions of economic activity. The disruptions which accompanied the business cycle were a major factor in the transformation of the dominant ideology in the U.S. from a general adherence to laissez-faire doctrines to an ideology of political capitalism which viewed the state as a necessary instrument for the rationalization and stabilization of an inherently unstable economic order. This transformation in ideology paved the way for the full-scale cartellization [sic] of the banking sector through the Federal Reserve System. The pressure for systematic state intervention in the banking sector originated both among the banks themselves and from certain industries which, because of capital intensive production processes and long lead-times, sought the stability necessary for the long-term planning of their investment strategies. The historical evidence confirms that the Federal Reserve legislation and other forms of state intervention in the banking sector during the first decades of the twentieth century received active support from influential banking and industrial interests. . . . ["Toward a Theory of State Capitalism: Ultimate Decision-Making and Class Structure," *Journal of Libertarian Studies*, 1977.]

One of the major consequences of inflation is a shift of wealth and income toward banks and their beneficiaries.

As Grinder and Hagel explain, "[C]artellization [sic] of banking activity permits banks to inflate their asset base systematically." This has the effect of strengthening the "ultimate decision-making authority" of banking institutions over "the activities of industrial corporations," and, by extension, "the capital market." These banking institutions serve as a key "intermediary between the leading economic interests and the state."

Thus one of the major consequences of inflation is a shift of wealth and income toward banks and their beneficiaries. But this financial interventionism also sets off a process that Hayek would have dubbed a "road to serfdom," for inflation introduces a host of distortions into the delicate structure of investment and production, setting off boom and bust and, in Grinder and Hagel's words, "a process of retrogression from a relatively free market to a system characterized by an increasingly fascistic set of economic relationships."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Just as the institution of central banking generates a "process of retrogression" at home, engendering additional domestic interventions that try to "correct" for the very distortions, conflicts, and contradictions it creates, so too does it make possible a structure of foreign interventions. In fact, it can be said that the very institution of central banking was born, as Rothbard argues in *The Mystery of Banking*, "as a crooked deal between a near bankrupt government and a corrupt clique of financial promoters" in an effort to sustain British colonialism. The reality is not much different today, but it is a bit more complex in terms of the insidious means by which government funds wars, and thereby undermines a productive economy.

So where does this leave us today?

Much has already been said about the most recent financial crisis, viewed from a radical libertarian and Austrian perspective, which helps to clarify its interventionist roots. (See, for example, Steven Horwitz's "An Open Letter to My Friends on the Left," http://tinyurl.com/3eq6g8, and Sheldon Richman's "Bailing Out Statism,"http://tinyurl.com/dkbvw9.) The seeds for this particular crisis were planted some years ago. The origins of the housing bubble can be traced to the creation of Fannie Mae and Freddie Mac, government-sponsored enterprises that extended risky loans to low-income borrowers in the hopes of expanding the "ownership society." But the larger crisis must be understood within the wider political-economic context shaped by inflationary government and Federal Reserve policies that fueled a binge of reckless borrowing. Horwitz explains:

> All of these interventions into the market created the incentive and the means for banks to profit by originating loans that never would have taken place in a genuinely free market. It is worth noting that these regulations, policies, and interventions were often gladly supported by the private interests involved. Fannie and Freddie made billions while home prices rose, and their CEOs got paid lavishly. The same was true of the various banks and other mortgage market intermediaries who helped spread and price the risk that was in play, including those who developed all kinds of fancy new financial instruments all designed to deal with the heightened risk of default the intervention brought with it. This was a wonderful game they were playing and the financial markets were happy to have Fannie and Freddie as voracious buyers of their risky loans, knowing that US taxpayer dollars were always there if needed. The history of business regulation in the US is the history of firms using regulation for their own purposes, regardless of the public interest patina over the top of them. This is precisely what happened in the housing market. And it's also why calls for more regulation and more intervention are so misguided: they have failed before and will fail again because those with the profits on the line are the ones who have the resources and access to power to ensure that the game is rigged in their favor.

If elements of the current housing bubble can be traced to Clinton administration attempts to appeal to traditional Democratic voting blocs, it's not as if the banks were dragged kicking and screaming into lending those mortgages.

This is precisely correct; indeed, there are those of a certain political bent who might seek to place blame for the current financial crisis on the recipients of subprime mortgages, particularly those in minority communities. But if elements of the current housing bubble can be traced to Clinton administration attempts to appeal to traditional Democratic voting blocs, it's not as if the banks were dragged kicking and screaming into lending those mortgages. This is, in a nutshell, the whole problem, the whole *history*, of government intervention, as Horwitz argues. Even if a case can be made that the road to this particular "housing bubble" hell was paved with the "good intentions" of those who wanted to nourish the "ownership society," their

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

actions necessarily generated deleterious unintended consequences. When governments have the power to set off such a feeding frenzy, government power becomes the only power worth having, as Hayek observed so long ago.

We heard a lot about "change" during the last presidential campaign, and about the necessity to end the influence of Washington lobbyists on public policy. But that influence exists because Washington has the power to dispense privilege. And privileges will always be dispensed in ways that benefit "ultimate decision-makers." That's the way the system is rigged. It is not simply that intervention *breeds* corruption; it's that corruption is *inherent* in the process itself.

It is therefore no surprise that the loudest advocates for the effective nationalization of the finance industry are to be found on Wall Street; at this point, failing financiers welcome any government actions that will socialize their risks. But such actions that socialize losses while keeping profits private are a hallmark of fascist and neofascist economies. They are just another manifestation of "Horwitz's First Law of Political Economy" ("Capitalists, Capitalism, and the Siren's Song of Stability," http://tinyurl.com/cw9nbt): "No one hates capitalism more than capitalists."

It is the government's monetary, fiscal, and global policies that have created insurmountable debt and record budget deficits, speculative booms and bubble bursts. What is needed is genuine *structural* change. But the primary battle is an intellectual and cultural one. It requires that we question the fundamental basis of the current statist system. FEE

FEE
FOUNDATION FOR ECONOMIC EDUCATION
History is a guide to navigation in perilous times. History is who we are and why we are the way we are.
– David C. McCullough
LESSONS FROM HISTORY WE DARE NOT IGNORE
A FEE SEMINAR IN MONTANA
May 29-31, 2009
LOCATION:
Fairmont Hot Springs Resort, Fairmont, MT
SPEAKERS:
Lawrence W. Reed, President, FEE
Burton W. Folsom, FEE senior historian and professor of history, Hillsdale College, author of The Myths of the Robber Barons and New Deal or Raw Deal: How FDR's Economic Legacy Has Damaged America
Sheldon Richman, Editor, The Freeman
COST:
Early bird (before May 15): $250 per person, includes breakfasts, dinners and Saturday lunch; does not include room charges.
After May 15: $275/person
online registration at www.fee.org

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Capitalism: Yes and No

BY CLARENCE B. CARSON

Some terms and phrases are well suited to lucid discourse and even debate. This is generally the case when they have a commonly accepted meaning, when they are generally used—or are capable of being used—with some precision, and when they are not overloaded with connotations. The fact that people differ as to the value or desirability of what the terms signify does not disqualify them. Otherwise, debaters would have to employ different terminology, depending on which side they were on. For example, it seems to me that "free market" meets the criteria of a phrase well suited to discourse and debate.

That is, "free market" has a commonly accepted meaning, can be used with precision, and is not overloaded with meaning so as to be value-laden. A free market is a market open to all peaceful traders, one in which sellers are free to sell to the highest bidder and buyers are free to buy what they will from whatever seller they will. Or, to put it another way, it is a market in which buyers and sellers are free to contract without obstruction or interference from government.

Thus when government intervenes in the market so as to restrict the number of sellers or buyers, to set prices, or to prescribe quality, it is not a free market. It is possible to oppose or favor such a market while agreeing as to what constitutes a free market. Nor do differences as to the extent of freedom entailed necessarily rule out the use of the phrase in discourse.

The Soviet Union used slave labor to satisfy its obsession with capital accumulation.

In a similar fashion "free enterprise" and "private property" generally meet the tests as terms of discourse. Enterprise is free when all who can and will may produce and dispose of their goods to willing buyers. The opposite of free enterprise would be government-granted monopoly over any field of endeavor, or the restriction of it through franchises, licenses, or other devices which exclude some enterprisers. The phrase can be used both by those who favor and those who oppose it, though those who oppose it might prefer other language. Private property is simply property that is privately owned, and the owner is protected in his enjoyment of it by government. I have not, of course, exhausted the distinctions nor covered all the areas about which disagreement may exist for any of these phrases, but it was my purpose only to make a prima facie case for them as terms of discourse.

Capitalism: A Value-Laden Word

The same does not go, however, for *capitalism*. It does not have a commonly accepted meaning, proponents of it to the contrary notwithstanding. As matters stand, it cannot be used with precision in discourse. And it is loaded with connotations which make

The late Clarence Carson was a prolific historian and Freeman *contributor. This article originally appeared in the February 1985 issue of* The Freeman.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

it value-laden. Indeed, it is most difficult for those who use it from whatever side not to use it simply as an "angel" or "devil" word, i.e., to signify something approved or disapproved. Meanwhile, what that something is goes largely unspecified because it is hidden beneath a blunderbuss word.

My considered opinion is that *capitalism* is not a descriptive word at all in general usage. Dictionary-like definitions may give it the appearance of being descriptive. One dictionary defines it as "a system under which the means of production, distribution, and exchange are in large measure privately owned and directed." On the face of it, the meaning may appear clear enough. We can come in sight of the difficulty, however, if we turn the whole thing around and look at what is supposed to be signified, shutting out of our minds for the moment the word used to signify it. Suppose, that is, that we have a set of arrangements in which the means of production, distribution, and exchange of goods "are in large measure privately owned and directed." I am acquainted with such arrangements, both from history and from some present-day actualities.

"Capitalism" does not have a commonly accepted meaning, cannot be used with precision in discourse, and comes loaded with connotations which make it value-laden.

But why should we call such arrangements *capitalism*? So far as I can make out, there is no compelling reason to do so. There is nothing indicated in such arrangements that suggests why capital among the elements of production should be singled out for emphasis. Why not land? Why not labor? Or, indeed, why should any of the elements be singled out? Well, why not call it *capitalism*, it may be asked? A rose by any other name, Shakespeare had one of his characters say, would smell as sweet. That argument is hardly conclusive in this case, however, nor in others similar to it. Granted, when a phenomenon is identified it may be assigned a name, and in the abstract one name will do as well as another, if the name be generally accepted. In the concrete, however, the name should either follow from the nature of the phenomenon or be a new word. Otherwise, it will bring confusion into the language.

Marxist Derivations

Capitalism, as a word, does not conform to these strictures. Its root is capital, an already well established word in economics, used to refer to one of the elements of production. Moreover, *capitalism* gave a form to the word that already had a more or less established significance. When an "ism" is added to a word it denotes a system of belief, and probably what has come to be called an ideology. It is highly unlikely, if not linguistically impossible, for such a formulation to serve as a neutrally descriptive word for the private ownership of the means of production, and so on.

But we are not restricted to theory in our efforts to discover whether capitalism is simply a neutrally descriptive word. It was given currency in the highly charged formulations of Karl Marx and other enemies of private property. Marx's fame hardly stemmed from any powers he may have had for neutral description. On the contrary, he is best known for his extensive efforts to reduce all of reality and all relationships to the point where they fitted within the ideological scheme of class struggle. He had the kind of mind that reduces everything to a place within a single dominant system. Thus, the private production of goods is a system, a system reduced in his scheme to capitalism.

In discussing the dictionary-like definition of *capitalism*, I dropped the word "system" used in the dictionary and substituted the word "arrangement" for it. I did so because it seemed to me that a society could have arrangements in which the production of goods would be privately owned without this constituting a system. Arrangements for distinguishing between claimants of property and protecting such claims are necessary in society. But "system" is ominous when linked to *capitalism* on the one hand and the production, distribution, and exchange of goods on the other.

Private ownership of the means of production does not dictate any particular mode of production. In point

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of fact, a great variety of modes of production do occur under private ownership. A man may own his own land and cultivating devices and produce what he will by his own efforts. Many have, and some do. Or, to take the other extreme, production may be organized in great factories by intricate division of labor and under extensive supervision and direction. Between these two extremes, there are in fact a great range of ways in which production and distribution have been and are carried on. Indeed, it is only where private property is the rule that this variety is possible.

In Marx's mental world this variety and diversity could not exist, or, if it did, it could not last. It must all be finally reduced to a single system—capitalism. And capitalism led to greater and greater concentrations of wealth until all was in a few hands. Then, of course, the apocalypse must come, the revolution, in which an impoverished proletariat would rise up in its wrath and seize the instruments of production, and so on and on through the whole Marxian scenario. The word *capitalism* still carries the overtones of this Marxian analysis. For example, the dictionary from which was drawn the earlier definition gives as further definitions of *capitalism*: "the concentration of capital in the hands of a few, or the resulting power or influence," and "a system favoring such concentration of wealth." Another dictionary says, "The state of owning or controlling capital, especially when tending to monopoly; the power so held."

Capitalism gained its currency from Marx and others as a blunderbuss word, misnames what it claims to identify, and carries with it connotations which unfit it for precise use in discourse.

The High Cost of Salvage

In sum, *capitalism* gained its currency from Marx and others as a blunderbuss word, misnames what it claims to identify, and carries with it connotations which unfit it for precise use in discourse. Even so, there has been a considerable effort to reclaim the word for discourse by some of those who are convinced of the superiority of privately owned capital in the production, distribution, and exchange of goods. It is a dubious undertaking. For one thing, Marx loaded the word, and when all that he put into it has been removed, only the shell remains. For another, linguistically, it does not stand for private property, free enterprise, and the free market. It is false labeling to make it appear to do so. *Capitalism* means either a system in which capital holds sway, which is largely what Marx apparently meant, or an ideology to justify such a system.

It is not my point, however, that it might not be possible to use *capitalism* as a label for private property, free enterprise, and the free market. Indeed, I think it has been done at what I call the bumper-sticker level of discourse in the United States. Undoubtedly, if enough effort were put into it the name of roses could be changed to "tomatoes." But I doubt that the game is worth the candle. Moreover, there is no real discourse, nor discursive reasoning, at the bumper-sticker level. Bumper stickers assert; they do not reason or prove. So do titles of books, for example. But labeling is an inferior art, and name-calling is a form of propaganda. Thus the problem of discourse with a word such as *capitalism* remains.

It is not my intention, however, to suggest that we should discard the word *capitalism*. Far from it. Rather, I see the need for the use of the word in its inherent sense in serious discourse. A word, certainly a word formed with an "ism" suffix, is governed by and takes its meaning from its root. Granted, words sometimes slip their moorings in the course of time and lose all connection with earlier meanings. This is apt to happen, I suspect, when the root word has fallen into disuse. That has by no means happened in the case of *capital*. Capital itself is as important today as ever, and the word is still in widespread use to describe it with considerable precision. Moreover, something that I would like to see correctly identified as capitalism is widespread, if not rampant, in the world.

Keeping in mind that *capitalism*, because of the "ism," is ideological in form, it means most basically an

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ingrained preference for capital over the other elements of production. That is, it means an imbedded preference for (or commitment to) capital over land and labor. Considered as a system, capitalism is the establishment of that preference by the exercise of government power. To put it into more precise economic terms, it is the forced transformation of some greater or lesser portion of the wealth of a people into capital. In political terms, it is the legalization and institutionalization of a preference for capital.

State Capitalism

Ironically, in view of Marx and socialist doctrine generally, capitalism is most rampant in communist countries. It is there that the most extreme measures are taken to accumulate capital. The Soviet Union, for example, has long used slave labor to mine gold in forbidding climes. It has done the same for cutting timber in the arctic cold of Siberia and for reaching other hard-to-get natural resources. The basic aim of much of this is capital accumulation to foster industrialization. There is perhaps no better way to visualize the preference for capital over labor than political prisoners (slave labor) working in gold mines. But it does take other forms. There is confiscatory taxation, in which most of the wealth of all who produce is taken away for use by the state. The capital hunger in Third World countries is ravenous today, as they reach out to try to obtain it from countries in which there is more wealth. The thrust is for industrialization, and the industries are usually owned by the government.

Some writers who have noted this penchant of socialist and communist countries for capital have called it state capitalism. While the phrase is not objectionable, it may well be redundant. If my analysis is correct, all capitalism is state-imposed capitalism. Otherwise, it is most unlikely that there would be an established preference for capital over land and labor.

Granted, some people in their private affairs do evince a preference for capital over other sorts of expenditures. I have known men, for example, who were much more given to buying tools and various equipment than clothes. But then the same men often spend more on automobiles, not usually capital expenditures, than on either. Nor is it likely that businessmen, however enamored they may be with machinery or computers, will make so bold as to ignore the market for long in determining the mix of the elements of production. Only governments, because they spend what they have not earned, can afford to do that or have the power to require others to ignore the market. Capitalism is a will-of-the-wisp unless it is established by the state.

> Keeping in mind that *capitalism*, because of the "ism," is ideological in form, it means most basically an ingrained preference for capital over the other elements of production.

A Red Herring

The notion that the conflict in the world is between capitalism and socialism is a Marxian red herring. Whether Marx deliberately conceived a perverse term to designate the conflict or not, it has had remarkable success in confusing the issue. In Marxian terms, capitalism is not simply the private control over the instruments of production. It is the effective ownership and control over the instruments of production by a few men with vast concentrated wealth at their disposal. In Marxian terms, again, this great wealth was obtained by the ruthless exploitation of workers. To argue the opposite position is to risk falling into a fairly well-laid trap. At the most obvious level, it is to take on a variation of the old conundrum of whether or not you are *still* beating your wife.

Thus the defender of *capitalism* begins by granting that, sure, nineteenth-century capitalists were a hard lot. But that has all changed in the twentieth century, he maintains; humane legislation and genteel businessmen have changed all that. To sustain this argument, he grants more and more of the Marxist, or at least the socialist, case and justifies the increasing government control over private property. Those who argue in this wise have taken the socialist bait and rushed headlong into socialism with it.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

But the heart of the difficulty is that the word *capitalism* as it is employed is a semantic trap. On the one hand, it makes it difficult to keep the issues in focus, because it is used in a confusing and misleading way. On the other hand, it blocks from our view a mass of phenomena which we need to see clearly and which *capitalism* used in its root sense would help to do. The issue is not between capitalism and socialism. There is an issue about private versus public ownership of the means of production, but there is no logical connection between that and capital or capitalism.

Whatever Marx may have thought about capital—all too little apparently—there is no substantial difference among the leaders in the world today over the necessity for and desirability of capital to aid in both agricultural and industrial production. If anything, socialist countries are more determined to get their hands on accumulated capital and concentrate it than what remains of so-called capitalist countries.

Every device, ranging from the most sneaky to the most openly confiscatory, is employed in this quest. I nominate as the most sneaky the monetizing of debt, by which wealth in private hands is sopped up by a process of monetary debasement. There exists now a vast series of banking-like mechanisms by which this money is sopped up and transferred to countries around the world where governments more or less own and control the instruments of production. Capital is what much of this is about, and if we could call it by its proper name, it would be called *capitalism*. As matters stand, however, we are denied the use of the very word that could help to bring all this into focus.

The issue is not between capitalism and socialism. There is an issue about private versus public ownership of the means of production, but there is no logical connection between that and capital or capitalism.

Freedom Versus Tyranny

The issue, I repeat, is not between socialism and capitalism, in any meaningful sense of the words. In the broadest sense, it is between freedom and tyranny. As regards capital, it is between whether men shall be able to keep the fruits of their labor and dispose of accumulations of it as they think best, or have it confiscated and used for politically determined ends. It is between the free market and the hampered market. It is between free enterprise and state-controlled activity under the direction of a vast bureaucracy. It is between dispersed wealth under individual control and concentrated wealth used to augment the power of the state. It is between the right to private property and the might of centralized government thrusting for total power. There are other dimensions, moral and social, to the contest, but the above are the major economic ones. *Capitalism*, as currently used, tends to act as a red herring to draw us off the scent and draw attention to largely extraneous issues.

So, I conclude, as regards the use of the word *capitalism*, *sic et non*, or, in English, yes and no. No, to take that part of the equation first, the word cannot be effectively used in discourse and debate in its Marxian or socialist sense. It cannot be used with precision because it is a loaded word, loaded with Marxian ideology. It has been severed from its root and made to connote what it does not clearly do. Nor does it have a commonly accepted meaning, or set of meanings, for Marxists and non-Marxists. Its use obfuscates the issues and conceals a major aspect of socialism (i.e., its capital hunger).

No, *capitalism* is not an apt word for the use of defenders of private ownership of the means of production. Linguistically, it does not mean private ownership, nor does the case for private property hinge upon its potential use as capital. The right to private property is grounded in the nature of life and labor on this earth, and it is, therefore, a gift of the Creator. Its use as capital is one of the possibilities of property. To defend private property from the perspective of the advantages of privately disposed capital is to approach the matter wrong end to. In any case, *capitalism* is still a misnomer for what the defenders are discussing; their flanks are exposed to the adversary because it is his chosen ground; and when the defend-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ers have loaded the word with their own meanings it does not have a commonly accepted meaning for use in discourse.

Socialists Seize Capital to Achieve Industrialization

Yes, there is a place for the word *capitalism* in the language. There is an ideology and there are practices which cry out to have this word stand for and identify them. The ideology is the established preference for capital over the other elements of production. In practice, it thrusts to the use of government power to concentrate capital, to promote its accumulation, and to confiscate the wealth necessary to that end. Used in this way, the word *capitalism* helps to identify and bring into focus developments which are otherwise difficult to construe.

We can see clearly that capitalism is a disease of socialism, not the offspring of private property. It is not a system in which the instruments of production are privately owned, but one in which private property is taken to provide capital for publicly owned industries. Perhaps the most dramatic examples of it at the present time are the grants and loans to Third World and communist nations by which wealth from the United States and European countries is being appropriated for their industrialization. That, by my understanding, is capitalism, and it should bear the name and onus. FEE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Ought Implies Can

BY STEVEN HORWITZ

One of the most common objections to free markets is that they ignore ethical considerations. In particular, critics argue that there are many things we "ought" to do that they believe will make people's lives better off. We ought to "redistribute" income to the poor, they say. We ought to make health care a right. We ought to fix the economy by bailing out the financial industry.

The problem with all these "oughts" is that they eventually confront the principle *ought implies can*. Can the desired end (improving the welfare of the poor, for example) be achieved by the chosen means (income "redistribution")? If not, then what does the "ought" really mean? "Oughts" without "cans"—ethical pronouncements without economics—are likely to lead to disastrous public policies.

In exploring the relationship between economics and ethics, we can start with two definitions that seem relevant here. The economist David Prychitko once defined economics as "the art of putting parameters on our utopias." And in a particularly insightful definition, Nobel laureate F. A. Hayek wrote that "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." What both definitions suggest is that economics deals with the realm of the *possible* and in doing so demarcates the limits to what should be imaginable. Before we say we "ought" to do something, perhaps we should be sure we *can* do it, in the sense that the action is likely to achieve the intended ends. Put differently: *ought implies can*.

Ethicists can imagine all kinds of schemes to remedy perceived social ills, but none of the aspiring benefactors can afford to ignore economic analysis. Being able to dream something doesn't guarantee it is possible. Too often ethical pronouncements have an air of hubris about them, as the pronouncer simply assumes we can do what he says we ought to do. By contrast, economics demands some humility. We always have to ask whether it's humanly possible to do what the ethicists say we ought. To say we ought to do something we *cannot* do, in the sense that it won't achieve our end, is to engage in a pointless exercise. If we cannot do it, to say that we ought to is to command the impossible.

Too often ethical pronouncements have an air of hubris about them, as the pronouncer simply assumes we can do what he says we ought to do.

So contrary to the commonly heard complaint, it is not that economists ignore ethical issues. Rather we attempt to describe the likely results of putting particular ethical rules into practice. For example, someone can argue that a living wage is an ethical imperative, but that doesn't change the economic analysis of minimum-wage laws. Those laws increase unemployment and/or lead to reductions in nonmonetary forms of compensation among all unskilled workers, but especially the young, male, and nonwhite. No matter how much we think we ought to pass such leg-

Steven Horwitz (sghorwitz@stlawu.edu) is the Charles A. Dana Professor of Economics at St. Lawrence University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

islation as a way of helping the poor, the reality remains that economics shows us that we cannot help them that way. Those who argue we ought to have such a law can still pass it if they want, but they should do it with eyes wide open to the fact that it will not achieve the result they wish, no matter how much they think we ought to have it.

It might be more accurate to say that ethicists ignore economics than that economists ignore ethics. To the extent that good economics shows what we can and cannot do with social policy, it is engaged with ethics. After all, if the point of saying we ought to do X is that we think it will achieve some set of morally desirable goals, then knowing whether or not doing X will actually achieve those goals is, or at least should be, a key part of moral inquiry. One of the tasks that economists should set for themselves is to engage in this sort of dialogue with moral philosophers and others who argue from "oughts." Economist Leland Yeager's recent book *Ethics as Social Science* is a good example of how economics can inform ethical questions just this way.

Studying "Ought," Ignoring "Can"

The more interesting question is the degree to which moral philosophers are engaged with economics as they develop their theories. It might be true that introductory economics courses do not consider moral questions as often as they might, but it would seem at least as true that courses in ethics and religious studies are unlikely to confront either economic arguments or economic data that relate to their subjects. Exploring the "ought" without broaching the "can" will not get one far in designing policies that will achieve the intended results. One exception to this neglect of economics is the philosopher Daniel Shapiro's *Is the Welfare State Justified?* In that book he brings to bear a good deal of empirical data and economic theory on the question of whether the welfare state can do what its proponents claim for it. From the philosophy side, this is the kind of work that needs to be done.

Exploring the "ought" without broaching the "can" will not get one far in designing policies that will achieve the intended results.

Can Doesn't Imply Ought

Once we recognize the insight behind "ought implies can," we can see that the reverse is true as well. Just as we cannot do everything people say we ought, we ought not do everything we can. We see this in the frequent calls for political actors to "do something" in the face of a crisis. There are many things politicians can actually do in a crisis, and doing them is often fairly easy, especially if the politicians can generate a climate of fear to help make the "ought" seem more pressing. But the fact that they *can* do something does not always mean they *ought* to. Even if it is true that "yes we can," understanding the unseen and unintended consequences of what politicians are able to do should help us to decide whether they ought to do it.

Both ways of looking at "ought implies can" put economists in the position of throwing cold water on the plans and designs of social engineers left and right. This is what Prychitko and Hayek mean. Economists are thus often seen as only knocking down the ideas of others without coming up with solutions of their own. There is some truth to this claim. That is how economists spend much of their time. But it's an important function: showing why a proposed solution would only make matters worse is a valuable contribution to the broader process of solving the problem.

More relevant, however, is that economics teaches us that solutions are much more often found in the actions of individuals and organizations responding entrepreneurially to the situations they face. The notion of a top-down solution to any social problem is going to attract the economist's critical eye. In terms of "ought implies can," economists are often reluctant to say what everyone ought to do because no one person or group knows what people *can* do. If ought implies can, and "can" is particular people in particular contexts developing solutions to their problems, then it is difficult to say what we *all* ought to do, especially in a crisis. This is the way that Prychitko's and Hayek's definitions cash out in the real world.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

All the themes above have been on display in the current economic crisis. The bailout of the financial sector is a classic example of both letting the "ought" blot out the "can" and of assuming we ought to do whatever apparently can be done. The original promise of the bailout was that government would buy up the bad assets of troubled financial institutions then later resell the assets, making the real cost substantially less than the original $700 billion. Many critics, including many economists, suggested not only that this plan was counterproductive—because it only enhanced the likelihood that other firms would take unwise risks in the future—but also that the availability of those funds would lead to demands for the government to use them in other equally unproductive ways. That is more or less what has happened, as the bailout expanded to partial government ownership of banks and then demands from the auto and insurance companies to get in on the goodies. The plan changed again when the government announced it wouldn't purchase troubled assets but instead would inject money directly into banks and other kinds of businesses. But soon all the "oughts" were crashing against the limits of what can be done via government intervention. Meanwhile, the machinery of government did many things it *can* do—borrow and create money, for example—without the planners thinking very much about whether they *ought* to do any of those things.

The machinery of government did many things it can do—borrow and create money, for example—without the planners thinking very much about whether they ought to do any of those things.

Social scientists who disregard ethical issues abandon one of their central roles in bettering the human condition, and ethicists who ignore social science in formulating their moral prescriptions are negligent for not asking whether those solutions will achieve their stated ends. Only when both realize that ought implies can will we get public policies based on an accurate understanding of human interaction. FEE

Start your weekday morning with

In brief

One click of the mouse … and FEE's popular news e-commentary will come to your computer five days a week.

Subscribe online: www.fee.org or e-mail: Inbrief@fee.org!

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Making a Bad Bill Worse

BY JOHN STOSSEL

How do you make a dreadfully bad piece of legislation—the nearly $800-billion so-called "stimulus" bill—worse? Simple: Add protectionism.

The "Buy American" provision of the stimulus bill, which mandates the use of domestic iron, steel, and manufactured goods even if imports are cheaper, makes our trading partners nervous. That created a problem for President Obama: "I think it would be a mistake . . . at a time when worldwide trade is declining for us to start sending a message that somehow we're just looking after ourselves and not concerned with world trade," he said.

But some members of his party were elected on protectionist platforms, and they are not about to blow this chance to reward their union and industrial constituencies. What was Obama to do?

He did what old-style politicians always do: tried to have it both ways by resorting to vague rhetoric. He said he'd "see what kind of language we can work on this issue."

The Senate then added a line saying that the "Buy American" section must be "applied in a manner consistent with U.S. obligations under international agreements."

So is the law protectionist or not? It sounds as though our trade agreements must be respected, but as the *New York Times* noted, "[I]n many cases it [a "Buy American" provision] is not considered a violation of trade treaties." Public Citizen's protectionist website, Eyes on Trade, agrees: Under its trade agreements, the United States has "always been allowed to do most if not all of what is in the stimulus package."

As long as it remains in the bill, the "Buy American" section will haunt us. Protectionism is poison. Prosperity means having access to the least expensive goods the world has to offer. When we save money buying something cheaper from abroad, we have more money to spend on other things or to invest. Laws that force us to pay more for things cannot make us wealthier.

More Beggers and Hostile Neighbors

Protectionist unions and firms say that a "Buy American" policy creates jobs at home. But that is misleading, because while protectionism does save some American jobs—often temporarily—the policy also destroys jobs at home.

It destroys jobs in two ways. First, when foreigners lose sales here, they have fewer dollars with which to buy American exports or to invest in the U.S. economy. Jobs in the export sector disappear, and the jobs that would have been created through the new investment won't be created.

Second, when foreign nations retaliate against American exporters, even more jobs are destroyed.

"Buy American" is a dishonest slogan because it leads to a loss of American opportunities for prosperity. It is special-interest legislation that is paid for dearly by other Americans. As my first college economics professor, Burton G. Malkiel, wrote in the *Wall Street Journal*, "Beggar-thy-neighbor policies create more beggars and hostile neighbors."

"Buy American" is a dishonest slogan because it leads to a loss of American opportunities for prosperity. It is special-interest legislation that is paid for dearly by other Americans.

John Stossel is co-anchor of ABC News' "20/20" and the author of Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong, *now in paperback.* *Copyright 2009 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The alleged "stimulus" bill is a rotten idea to begin with. Government has no resources that it hasn't first taken from someone else. By borrowing nearly $800 billion to pay for pet political projects, government prevents that money from being used to rebuild the economy according to consumer preferences. Bad stimulus drives out good.

Willis C. Hawley and Reed Smoot.

Protectionism makes it even worse, and we should know better. In 1929-30, President Herbert Hoover and the U.S. Congress helped turn a depression into the Great Depression by enacting the infamous Smoot-Hawley tariff. Hoover's mere announcement that he would sign the bill pushed the stock market into the tank. Hoover and Congress then made their bad tariff decision worse by approving a "Buy America Act," which required federal projects to use only American supplies. Hoover signed it on his last day in office. Countries the world over retaliated, and by 1932, U.S. exports had fallen 64 percent, aggravating unemployment, which approached 25 percent.

The effects of the "Buy American" provision of the "stimulus" bill may not be as egregious, but who knows?

What we do know is that many of our so-called leaders have learned nothing from history. FEE

Online Now!

THE FREEMAN ONLINE

www.thefreemanonline.org

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

100 speakers, 200 exhibits, and over 1,000 free thinkers will soon gather at

FreedomFest 2009

July 9-11, 2009 ■ Bally's Las Vegas ■ www.freedomfest.com

"So good I changed my schedule to attend all 3 days!" — Steve Forbes

"FreedomFest is an intoxicating experience that leaves a permanent glow! Normally I am a harsh judge of such events, but the sessions at FreedomFest were on a remarkably high level. It was great sharing with so many diverse folks united by a love of liberty and learning." — Gene Epstein, *Barron's*

When was the last time you had an unforgettable 3-day weekend with friends — a chance to socialize, network, and celebrate life, liberty and the pursuit of happiness?

Join us and a thousand other free minds for the time of your life: **FreedomFest 2009**, set to take place **July 9-11, 2009** at Bally's Resort in the middle of the Vegas Strip.

We have big plans: Over a hundred of your favorite speakers, 9 great debates . . . Lots of good food and drink . . . beautiful people . . . and entertainment galore: Vegas shows and our very own gala Saturday night banquet.

FreedomFest is a Renaissance weekend you won't want to miss. It's not only about the economic crisis and geo-politics, but there's fascinating speakers on every topic imaginable — great debates, financial freedom, advances in science & technology, philosophy of life, healthy living, the arts and literature. There's something for everybody at FreedomFest!

Larry Kudlow

Lawrence W. Reed

Steve Moore

Larry Kudlow, Wall Street's #1 insider, will be our keynote speaker at this year's FreedomFest. His topic will be "Clear and Present Danger" as he heads up our **World Economic Summit** and 3-day financial conference along with **Steve Forbes, Doug Casey, Steve Moore, Dan Mitchell, John Fund, Charles Gasparino, Rick Rule, John Mackey,** and **Lawrence W. Reed, president of FEE.**

"All-Star Prediction Panel: Gurus who Predicted the 2008 Crisis — What are They Predicting Now?" with **Peter Schiff, R. E. McMaster, Prof. Fred Foldvary,** and **Alex Green,** moderated by **Mark Skousen,** editor of "Forecasts & Strategies" and producer of FreedomFest.

Nine Debates in 2009, including "Ideal US foreign policy--isolationist or imperialist?" . . . "Wal-Mart, Good or Bad for America?" . . . "Abe Lincoln: Best or Worst President?" . . . "Keynes vs. Hayek: Who Best to Solve the Financial Crisis?" . . . "China, Friend or Foe?" . . . "Should Hard Drugs be Legalized?" . . . "Should Big Corporations Be Philanthropists?"

Mini-Festival on Libertarian Science Fiction/Fantasy (Bradbury, Heinlein, Rand) . . . Sacred Text Series (hear true believers talk about their sacred scriptures) . . . Successful writers discuss "how to write a **classic** novel" . . .

Prof. Steven Watts (Missouri), biographer of Walt Disney and Hugh Hefner, on **juvenile and adult fantasy** in post-war America . . . Plus **Liberty Editors Conference (SRO!)** and **world's largest exhibit of freedom organizations** (past exhibitors include **Cato, Heritage, Fraser, Reason, FEE, Goldwater**) Official bookstore: **Laissez Faire Books** (a book lovers dream) . . . Plus fabulous gala **Saturday night banquet** (with surprise music group and the induction ceremony of **Free Market Hall of Fame**).

Other confirmed speakers: **Charles Murray, Brian Doherty, David Friedman, Michael Shermer** (Scientific American), **R. Emmett Tyrrell, Jr., Al Regnery, Richard Viguerie, and Matt Goodman** (founder, Blue Man Group).

EARLY BIRD SPECIAL: Register before April 15, and pay only $395 per person/$595 per couple. Fee includes three full days of general sessions and breakouts, all conference materials, exhibit hall, continental breakfast, and cocktail receptions. Room block at Bally's available for only $97 a night.

To register call Tami Holland at: 1-866-266-5101 or tami@freedomfest.com

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Capital Letters

Does Utilitarianism Deserve Bashing?

In an otherwise meritorious article ("The 'Risk' of Liberty: Criminal Law in the Welfare State," September 2008), Michael N. Giuliano parrots the tiresome old bashing of utilitarian ethics. (He sometimes says "consequentialism," but since versions of utilitarianism make up almost the entire set of consequentialist doctrines, the distinction is unnecessary here.) "The main component of utilitarianism," Giuliano writes, "holds that the rightness or wrongness of an action is determined purely by its consequences. . . . The law's reach under the utilitarian mentality is predicated on the belief that the ends justify the means." Unlike English and American tradition, which recognized personal liberties either preexisting or superseding government power, "The 'greatest happiness of the greatest number' rule . . . declar[es] that the ends justify the means. . . . The trek toward greater utilitarianism was in avowed opposition to the natural rights that . . . once 'morally' exonerated the humblest citizen in defiance of the highest authority."

Where does Giuliano get his notions about utilitarianism? Clearly not from the writings of such great philosophers and economists as David Hume, John Stuart Mill, Henry Hazlitt, Ludwig von Mises, and R. M. Hare (and F. A. Hayek, who was a utilitarian despite evidently disliking that label). Nor from Aristotle, whose eudemonism foreshadows the soundest strands of utilitarianism. No, Giuliano seems to be thinking, at n-th hand, of an extreme "act-utilitarianism" or "situation ethics," which would disregard principle and treat each case on its own supposed merits. This caricature version, if ever actually advocated, has nowadays become no more than a straw man for critics to blow down while claiming victory for their own favorite doctrines.

A sounder version, "rules" or "indirect" utilitarianism, recognizes powerful reasons for respecting principles, including those of natural or personal rights; and it distinguishes between good and bad personal characters, thus incorporating "virtue ethics." This version quite rejects recommending any specific behavior or policy just because its intended good consequences are thought likely to outweigh any bad ones. Instead, it endorses enduring principles like those of Giuliano himself, and precisely on grounds of utility, on the grounds that they are essential to "social cooperation," as Mises said, the kind of society affording free individuals the best prospects of achieving their various goals in life—in a word, happiness.

Like many of the critics whom he parrots, Giuliano takes Jeremy Bentham as his whipping boy. Not all but much that John Stuart Mill wrote deserves applause, including his essay on "Bentham" (1838). Mill understood Bentham's distinctive personality. Bentham was good at probing for the exact meanings, if any, of noble-sounding but possibly empty words and slogans. He was good at probing for the rationale of inherited institutions and legal technicalities. But Mill did not think much of Bentham as an original philosopher and regretted the publication of his *Deontology*. Bentham's offhand remark about the greatest good for the greatest number, uncharitably interpreted, is indeed nonsense. His faith in the great benefits that suitably instructed legislators could achieve is, as we now see, gravely misplaced. Bentham was far from being the soundest of utilitarians, and it is just wrong to take him as defining what utilitarianism is all about.

Public policy is largely ethics, applied or misapplied. What, then, does Giuliano conceive of as the soundest basis for ethics? Principles of honesty, property, freedom, and rights, as well as the distinction between good and evil, are decisive for a good society and human happiness; but they are not irreducibly intuited ultimates: they can be explained and argued for. Would Giuliano not argue for them? What grounds for them could he find, other than ultimately utilitarian grounds? Conceivably the authors of the policies that Giuliano rightly condemns had the parrot-like misinterpretation of utilitarianism at the back of their minds. That is no excuse, however, for giving the misinterpretation further currency.

—LELAND B. YEAGER
Auburn University (Emeritus)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Michael Giuliano replies:

Professor Yeager's response to my article suggested that the view of utilitarianism represented therein was a "caricature version" that "has nowadays become no more than a straw man for critics to blow down." The article was referring to a certain species of utilitarianism in order to provide one possible explanation, among several, as to how the welfare state has lowered the threshold of allowable risk such that more and more behavior is elevated toward artificial criminality.

My reason for criticizing this "caricature" version of utilitarianism, this version that is "indeed nonsense" according to Yeager, is that it is the version that legislators and other lawmakers so often adopt if only implicitly and independently of any actual theory. It is rarely sophisticated "rules" utilitarianism that is the force behind legislative crusades. Bentham's "oversimplified test" involving "Pleasure-and-Pain, or the Greatest Happiness," as Hazlitt observed, could conceivably be applied in a blind "manner to all traditional ethical judgments." That much of our legislation follows a similarly sweeping rule was the true object of my criticism.

Bentham was used as the example because these oversimplified tests are, in the most basic way, generally identified with utilitarianism applied in the more common situational and legislative settings. I had no intention of suggesting that this was truly the best of utilitarianism as understood in an academic, philosophical sense. I am compelled to defer to the esteemed Professor Yeager as to the best and most appropriately understood utilitarianism as that concept might be used before an academic background.

My argument was hardly that, emanating from the ink and pen of Bentham, his ideas directly flowed through the strands of history into the conscious minds of lawmakers. Perhaps there might be a certain indirect relationship. The point was simply that much of the *criminal* legislation at issue (though I do not suggest a formalistic distinction between criminal and other enactments) was based on transient public demands and outcries and limited by no particular ethical judgment at all.

As Professor Yeager concluded his response with the observation that the lawmakers might have "had the parrot-like misinterpretation of utilitarianism at the back of their minds," it is apparent that he essentially recognized my point, however clouded it may have been by a semantically sweeping condemnation that had as its purpose a brief point in the essay. The utilitarianism I referred to was not, excepting the point on Bentham, intended to generally diminish scholarly utilitarian thought, but was instead focused toward the garden-variety utilitarianism that often animates the lawmakers creating the legal landscape we live in.

We will print the most interesting and provocative letters we receive regarding articles in *The Freeman* and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *The Freeman*, FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; e-mail: freeman@fee.org; fax: 914-591-8910.

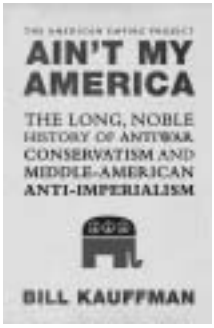
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Book Reviews

Ain't My America: The Long, Noble History of Antiwar Conservatism and Middle-American Anti-Imperialism

by Bill Kauffman
Metropolitan Books • 2008 • 304 pages • $25.00

Reviewed by Christopher Westley



The abysmal 2008 presidential election should have Americans scratching their heads, pondering how the political economy of the United States devolved into a duopoly of two nearly identical, state-loving political parties that are always ready to intervene militarily anywhere on the planet.

It was not always this way, and how we got here is the focus of Bill Kauffman's *Ain't My America*. The book is a pithy romp through American history, focusing on antiwar and antistate advocates from eighteenth century Antifederalists to the brave, post-9/11 minority who still dare to say no to an overweening federal government. The result is a remarkable effort that connects John Randolph to Freda Payne, George Washington to George McGovern, William Cullen Bryan to Bob Dylan, and a host of noble and colorful iconoclasts in between.

Kauffman identifies a long-running American strain of individualist thought crucial to a free society, one with two notable characteristics. The first is a recognition of the devastating effects of war on the natural order. Here Kauffman connects the popular dissent to the War of 1812, the Mexican and Spanish-American wars, the twentieth century's world wars, the Cold War, and Vietnam. Common threads include the beliefs that war is unnecessary, that it serves vested interests over the general interest, that essential freedoms will be compromised in carrying it out, that the common man will pay with treasure and blood, and that it will lead to a permanently expanded state.

The second philosophical characteristic of a free society important to Kauffman is that of localism. Here the idea of maintaining roots and revering the local over the international—the anchored over the unanchored—is important for constraining the nation-state. Indeed, for a nation-state to grow, it needs dependents willing to abandon the ties of hearth, home, and family, if only because this helps when sending soldiers off to one of the 100-plus countries where the U.S. government has military bases. Kauffman emphasizes the important contributions of Allan Carlson of the Howard Center on the full costs of nationalism and militarization on families and communities. Kauffman concludes: "Divorce, dispersal, disruption of courtship patterns; ye shall know the warfare state by its rotten fruits."

Kauffman introduces his readers to people like John Randolph, who opposed the War of 1812 by asking, "Who would suffer [by war]? The people. It is their blood, their taxes, that must flow to support it." Noting the loss in freedoms war brings, Randolph added, "The Government of the United States was not calculated to wage offensive foreign war—it was instituted for the common defence and general welfare; and whosoever should embark it on a war of offence, would put it to a test which it was by no means calculated to endure."

Another outspoken critic Kauffman introduces is George S. Boutwell, who had been Grant's treasury secretary and later broke with President McKinley in opposition to the war with Spain and the (virtually unknown today) slaughter of Filipinos following their "liberation." Asked Boutwell: "Is it wise and just for us, as a nation, to make war for the seizure and government of distant lands, occupied by millions of inhabitants, who are alien to us in every aspect of life, except that we are together members of the same human family?"

Such anti-imperialists of the nineteenth century would pass the baton to the Veterans of Future Wars and America Firsters of the twentieth, a time when criticizing the government's wars could land you in jail. Kauffman describes a South Dakota farmer who served a year and a day in prison for saying, "If I were of conscription age and had no dependents and were drafted, I would refuse to serve. They could shoot me, but they could not make me fight." Kauffman also describes the efforts to pass the Ludlow Amendment in the late

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

1930s to counter the New Dealers' well-known penchant for warfare. This amendment would have required all declarations of war to be approved by national referendum, but it failed in a close House procedural vote.

Lastly, Kauffman chronicles the rise of the New Right following World War II, led by a cadre of ex-communists to promote the militarization of society in order to defeat "the god that failed them, the Soviet Union and world communism." The great individualists who bemoaned the costs of that campaign included Howard Buffet, Harold R. Gross, Murray Rothbard, Robert Taft, Felix Morley, and others, many of whom wrote for *The Freeman*.

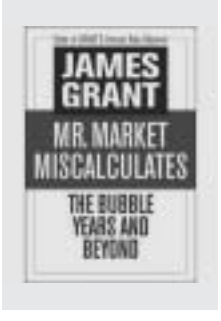
Ain't My America is not your high school civics text. In our era of centralized education with No Child Left Behind, that may be its strongest attribute. FEE

Christopher Westley (cwestley@jsu.edu) is a professor of economics at Jacksonville State University in Alabama.

Mr. Market Miscalculates: The Bubble Years and Beyond

by James Grant
Axios • 2008 • 430 pages • $22.00

Reviewed by George C. Leef



Veteran financial writer James Grant describes himself as a "Grover Cleveland Democrat"—that is, someone who believes strongly in sound money, free trade, and *very* limited government. *Mr. Market Miscalculates* is a collection of his essays published in "Grant's Interest Rate Observer" over the last decade. While most financial writers credulously accept the notion that central banks must regulate economic activity and are mesmerized by the oracular mutterings of Federal Reserve chairmen, Grant treats it all with disdain. He sees the Fed not as a brilliant modern innovation, but as a dangerous political contraption that interferes with the free market's smooth order. And as for Fed chairmen, Grant regards them as deluded as the emperor who thought he was wearing the most exquisite of clothes when in fact he was wearing nothing.

Most readers will be interested primarily in knowing what Grant thinks about our current financial crisis. Prominent politicians have declared that it's due to that nasty old villain, the free market. Not even close, says our author. Instead he points to the belief held by former Fed chairman Alan Greenspan that the U.S. economy needs steady inflation. Following the dot-com recession of 2000, Greenspan feared that the economy would suffer from deflation if the Fed didn't shovel in loads of money. That's just what he did, driving interest rates down to almost nothing.

Grant, who obviously learned his economics and history well, looks askance at Greenspan's beliefs. For one thing, there is nothing to fear from deflation. The American economy had long periods of deflation in the nineteenth century while at the same time enjoying rapid economic growth. That was in the primitive days prior to wizards in Washington expertly running macroeconomic policy, but, amazingly, things worked out quite well.

Furthermore, Grant understands that the government can't magically create capital out of nothing. Through central-bank inflation it can temporarily drive down interest rates, but that bit of economic fakery can't succeed for long. Capital only comes from saving, not government money creation. All that artificially low interest rates can do is to trick people into changing their behavior, putting money and resources where they otherwise wouldn't have. In this instance, the government managed to create "a gigantic bubble of mortgage debt." It's almost humorous to listen to Greenspan babble away, denying that the Fed had anything to do with the mortgage debacle, but Grant won't let him off the hook.

What about the popular notion that we benefit from "mild" inflation? The new Fed chairman, Ben Bernanke, says that his approach is one of "inflation targeting," with the objective of maintaining a nice, predictable rate of around 2 percent annually. Grant dislikes the idea, observing, "Over a decade, a 2.5 percent rate of currency depreciation results in a 20.3 percent destruction of purchasing power." With a "mild"

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

inflation target, the government deliberately erodes the value of the dollar, and for what? So it can pretend to "stimulate" the economy, thus misallocating resources.

That makes the primitive days of the gold standard look good. Grant never sets forth a formal argument for dumping our failed experiment in irredeemable fiat money in favor of a monetary system based on tangible wealth, but he frequently alludes to the merits of the gold standard. He also writes sympathetically about the Austrian school. After introducing his readers to F. A. Hayek, Grant writes, "Money printing distorts prices and wages, the traffic signals of a market economy."

But don't we need government controllers to make certain that the economy remains "stable"? Grant thinks we'd be stable enough without them, thanks, but notes that we pay a high price for the stability mania. The trouble is that investors lower their guards when the Fed ladles out the elixir of cheap money. We wind up with portfolios bursting with junk paper and panic when the inevitable truth asserts itself.

Readers will savor the book's cartoons, but even more Grant's witty writing, which shows up on every page. Consider this jab at Greenspan:

> "Although the Federal Reserve System employs 485 Ph.D. economists, only one of them is a living symbol of the dynamic U.S. economy. And now this one man says that he didn't know about the stock-market bubble, couldn't have known and, even if he had known, wouldn't have been able to make a move against it. It isn't a great advertisement for a monetary dictatorship."

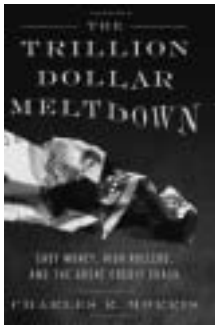
These essays are gems of contrarian insight. Sometimes they are a little heavy on the jargon of finance professionals, a language in which I'm not particularly fluent. Still, the big message comes through clearly. We have made a terrible blunder in putting control of our monetary system in the hands of individuals. We need to return to control by the forces of the free market. FEE

George Leef (georgeleef@aol.com) is book review editor of The Freeman.

The Trillion Dollar Meltdown: Easy Money, High Rollers, and the Great Credit Crash

by Charles R. Morris
Public Affairs • 2008 • 224 pages • $22.95 hardcover; $13.95 paperback

Reviewed by Michael S. Rozeff



The stocks of banks, investment banks, and associated financial institutions declined severely in 2007-08 when their many bad loans, first in subprime mortgages and then in other securities, surfaced. Scholars will be pondering this event for years to come, as they have with the Great Depression.

In this instant and brief history, Charles Morris, lawyer, banker, and author of several previous books, attempts to explain the origins of the bust and suggest remedies. The result, however, is disappointing. Morris dishes out a financial stew consisting of numerous ingredients: Volcker's and Greenspan's Feds, bank deregulation, monoline insurers, rating agencies, securitization, the Greenspan put, loose mortgage lending, hedge funds, and more. A reader unfamiliar with these matters will be duly alerted to many interesting features of the recent financial world. But, lacking a viable integrative theme, the sum is a confusing mishmash.

The first third of the book reviews superficially and in broad strokes some of the financial and economic history of the United States since 1973. The middle portion describes some of the signal events and players in the recent credit debacle. In the last third, Morris gives his take on the winners and losers and what should be done.

The story that Morris tells in the first and last parts of the book is the standard political line that the financial sector went too far in the direction of free markets, the financial players performed badly, and now matters must swing back to more government control.

For example, Morris contends that financial oversight by regulators has been lax. There is some truth to this, but Morris fails to view it as a sign of government failure. And he makes no serious attempt to delve into the effects of the panoply of regulations, subsidies, fed-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

eral guarantees, and tax-code features that promote home ownership for people unable to afford a house.

Like the mainstream consensus, Morris seems to misunderstand what makes a market truly free. The "financial meltdown," he says, came about from "coddling our financial industry, fertilizing it with free money, propping it up with unusual tax advantages for fund partners, and anointing it with fresh funds whenever it stumbled or scraped a knee." Those are hardly hallmarks of a free market!

Our financial markets are anything but free. Bond raters have a quasi-cartel. Banks and insurers are heavily regulated. Money is monopolized by the Fed. Institutional investors who are legally separated from their contributors feel free to experiment with hedge funds. Accounting, under the aegis of the SEC and acting in a quasi-governmental way, does not keep up with innovative players. Like most "mainstream" commentators, however, Morris insists that the financial debacle is the fault of our mythical free market.

If markets were free, financial players wouldn't be lavishing huge campaign contributions on congressmen in key positions. If markets were free, there would be no Fannie Mae and Freddie Mac sopping up mortgages across the nation, while repackaging and reselling them to institutional investors worldwide. If markets were free, Fannie Mae and Freddie Mac would not be in receivership.

Morris's "very first priority will be to restore effective oversight over the finance industry." But financial regulators do not now lack sufficient law and penalties. Morris doesn't realize that there cannot be effective management by Congress or its agencies of the many financial industries and sub-industries when their markets are highly politicized.

The author's choice of topics and coverage is often perfunctory and eccentric. The genesis of the real estate boom is given short shrift. He writes that it "may be one of those rare beasts conjured into the world solely by financiers." He does not discuss the role of falling home prices and negative home equity in mortgage defaults. Collateralized mortgage obligations come in for lengthy treatment, but he barely notes Fannie Mae and Freddie Mac's role in promoting such vehicles.

Behind the current deflation is a preceding inflation that had gone on since 1982. There has been no serious deflationary recession for decades. The Federal Reserve System and government officials encouraged the notion that they would not countenance a serious recession. They would prevent the downside risks of investing. That attitude, along with other political actions, encouraged a large debt or credit bubble to finance stock, bond, and real estate purchases.

The political system enabled a basic financial sin. That sin was overtrading or overleveraging. Market players and borrowers, thinking the risk of loss or downturn was minimal, borrowed too heavily and loaded up too highly on assets. When those asset prices fell, even by moderate amounts, their losses shot upward due to the effect of the borrowing.

This book was among the first published on our current financial debacle. Unfortunately, the author fails to see that the villain is government meddling. Look for something better. FEE

Michael Rozeff (msroz@buffalo.edu) is the retired holder of the Louis M. Jacobs Chair in Finance at the University of Buffalo.

The Leaders We Deserved (and a Few We Didn't): Rethinking the Presidential Rating Game

by Alvin S. Felzenberg
Basic Books • 2008 • 442 pages • $29.95

Reviewed by Burton Folsom, Jr.

Alvin Felzenberg, like many thoughtful scholars, has a beef with the way historians have evaluated American presidents. Ever since 1948, the year of the first Arthur Schlesinger, Sr. poll, historians have ranked American presidents and published the results. In the case of Schlesinger's poll, a select group of historians ranked all presidents (except for those who died early in their terms) as Great, Near Great, Average, Below Average, or Failure. The results were compiled, publicized, and taken as gospel by many journalists and professors. The high ratings for Franklin Roosevelt and Woodrow Wilson, and the low ratings for Calvin Coolidge and Ulysses Grant, sent the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

message that activist presidents were the ones to be admired.

Felzenberg argues that "the popularization of Schlesinger-style surveys . . . freed journalists, political commentators, museum curators, and students of all ages from having to offer *evidence* in support of their opinions." He adds, "An enduring limitation to the usefulness of presidential surveys has been bias on the part of the evaluators." Those are good points.

In *The Leaders We Deserved,* Felzenberg attempts to circumvent those problems by urging historians to use multiple criteria in their evaluations. He specifically suggests six areas: character, vision, competence, economic performance, foreign policy, and their efforts to preserve and extend liberty. By asking historians to assign grades to presidents in all six areas, Felzenberg wants to force them to use more evidence and less bias in formulating their evaluations.

Practicing what he preaches, Felzenberg uses these six areas to do his own rating of the presidents. He has chapters on each of his six areas, and he presents and defends his ranking of the presidents on a one-to-five scale in each. His conclusions in part mesh with previous surveys. Washington and Lincoln are still at the top, and Hoover and Nixon are tied for 34th place toward the bottom. The surprise comes when Ronald Reagan finishes third, Eisenhower fifth, Grant seventh, Coolidge 12th, and Lyndon Johnson falls to 27th.

Such results (and the discussion that precedes them) are refreshing and thoughtful. Felzenberg, with his multiple criteria, adds to the debate on evaluating presidents and exposes the simplicity of the Schlesinger poll and other surveys as well.

Biases, however, quickly creep into Felzenberg's own ratings. He gives George H. W. Bush a five on character (on a one-to-five scale) even though he promised no new taxes but increased the income tax anyway. Franklin Pierce and James Buchanan, by contrast, receive a one on character, but Felzenberg has little specific evidence to defend those low ratings. Perhaps the lack of success during their presidencies spills over in Felzenberg's mind into their character ratings.

A more serious question of judgment is when Felzenberg gives Franklin Roosevelt a rating of three on economic policy but James Madison only a one. After a blizzard of interventionist programs, FDR had almost 20 percent unemployment six years into his presidency. His treasury secretary, Henry Morgenthau, confessed in May 1939, "We have tried spending money. We are spending more than we have ever spent before and it does not work. . . . I say after eight years of this Administration we have just as much unemployment as when we started. . . . And an enormous debt to boot."

If FDR's economic performance rates a three, Madison's rating of one is just as puzzling. Whatever one thinks of his conduct of the War of 1812, Madison relied on bonds to pay for it instead of higher taxes, which might have become permanent after the war. He also insisted on state, not federal, spending for canals, which helped the U.S. government balance its budget so expeditiously that it soon had a federal surplus rather than a debt. Is it accurate to suggest that a president who doubles the national debt and has 20 percent unemployment rates a three, but one who cuts costs and paves the way for a federal surplus deserves only a one?

A similar problem occurs when Felzenberg gives FDR a rating of four in "preserving and extending liberty," while Grover Cleveland gets only a two. Cleveland vetoed 414 bills during his first term (twice the total vetoes of all his predecessors) in part to ensure that individual liberty was preserved from political encroachment. On the other hand, FDR signed numerous bills and issued many executive orders that violated the rights of citizens. Cleveland doesn't deserve his low score and FDR doesn't deserve his high one.

Historians will always quibble about their judgments. By insisting on evidence and on multiple criteria, however, Felzenberg's book has advanced the art of evaluating American presidents. FEE

Burton Folsom, Jr. (burt.folsom@hillsdale.edu) is professor of history at Hillsdale College, FEE's senior historian, and the author of New Deal or Raw Deal? *(Simon & Schuster, 2008).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Organizing and the Organized

BY CHARLES W. BAIRD

Congress permits unions to bargain for workers who do not want such representation, and it compounds this violation of freedom of association by permitting unions to force workers they represent to pay union dues and fees as a condition of continued employment. So-called union security has given rise to a circus of legal disputes which consume human resources that otherwise could be devoted to honest work.

Example: Should unions be permitted to charge workers who are already forced to accept their representation services for organizing expenses involved in the unions' attempts to capture hitherto union-free workers?

So-called union security has given rise to a circus of legal disputes which consume human resources that otherwise could be devoted to honest work.

Section 8(a)3 of the National Labor Relations Act (NLRA) gives a union the power to force objecting workers to pay fees to the union as a condition of continued employment. Section 2, Eleventh of the Railway Labor Act (RLA) imposes the same coercion in the railroad and airline industries. In its *Ellis* decision (1984) the Supreme Court ruled that organized workers under the RLA who object to the payment of union dues may be forced to pay only for collective bargaining, contract administration, and grievance adjustment. In its *Beck* decision (1988) the Court extended those same protections to objecting workers subject to the NLRA. In *Ellis* the Court specifically ruled out the expenditures a union incurs when it attempts to organize union-free workers as a permissible charge against already-organized objecting workers. In *Beck* the Court stated that Section 8(a)3 of the NLRA and Section 2, Eleventh of the RLA are "in all material respects identical," that they are "statutory equivalents," and that "Congress intended the same language to have the same meaning in both statutes."

Thus a reasonable person might conclude that under Section 8(a)3 already-organized objecting workers cannot be charged for a union's new organizing expenses. Indeed, even William Gould, a former chairman of the National Labor Relations Board (NLRB) who was appointed by President Clinton, expressed that view.

However, the NLRB has defied the Supreme Court. The NLRB examined the implications of the *Beck* decision for workers subject to the NLRA in *California Saw* (1995). It decided that expenses incurred by a union for activities outside an objector's bargaining unit may be charged 1) if they are "germane to the union's role in collective bargaining, contract administration and grievance adjustment;" and 2) if, following *Lehnert* (1991), a Supreme Court public-sector case, the charges "may ultimately inure to the benefit of the members of the local union by virtue of their membership in the parent organization." The specific expenses at issue in *California Saw* were litigation costs incurred by a parent union. Organizing costs were not part of the case.

The NLRB then defied the Court's *Ellis* ruling on organizing expenses in its *Meijer* decision (1999). It ruled that such charges, if they are for "organizing within the same competitive market as the bargaining unit employer," are permissible under the *California Saw* standard. Such organizing, the Board reasoned, inured to the benefit of the objectors by making collective

Charles Baird (charles.baird@csueastbay.edu) is a professor of economics emeritus at California State University at East Bay.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

bargaining on their behalf for higher (nominal) wages more successful. The Board held that the Supreme Court's ruling in *Ellis* was irrelevant because the intent of Congress, as stated in Section 1 of the NLRA, was to promote organizing. When Section 2, Eleventh was added to the RLA in 1951, the airline and railroad industries were already fully organized, so promoting organizing was not part of Congress's intent. This argument is a non sequitur because, notwithstanding Section 1 of the NLRA, the specific intent of Congress with Section 8(a)3, like Section 2, Eleventh, was to capture free riders. Congress never linked union security to organizing. The Supreme Court has not yet taken up this question, but since the Ninth and Fourth Circuit Courts of Appeal have issued different opinions it may. However, in the new political environment it may not.

The Economics

The NLRB rested its decision in *Meijer* on empirical evidence presented by economists' testimony that when unions successfully organize hitherto union-free workers in a specific competitive market, there will be fewer union-free employers against whom unionized employers will have to compete. This increases the ability of those employers to pass union-imposed cost increases forward to consumers, and thus makes the employers less resistant to union demands for higher wages. Thus increased organizing by unions will raise the wages paid to already-organized workers.

The expert witnesses referred to several empirical studies, using 1960s and '70s data and published in the '70s and '80s, which purport to show that a 10 percent increase in the number of workers who are unionized in a specific competitive market will on average increase nominal wages by 2 percent. Similar results were found in a 1992 study of the retail grocery industry commissioned by the United Food and Commercial Workers union, which had organized employees at Meijer, Inc., a retail grocery chain based in Michigan.

In 2004 John DiNardo and David S. Lee (DL) published an important paper that cast doubt on those studies, which were based on old household interviews as reported in the *Current Population Survey*. The DL study used enterprise-based data from 1984 to 1999, which track specific employers over time, to estimate the effects of new unionization on wages (and other outcomes). Moreover, the earlier studies did not adequately address the "selection bias" problem. It may be that instead of unionization leading to higher wages, unions try to organize profitable firms that are likely to pay higher wages in any case. DL controlled for selection bias by using a statistical technique called "regression-discontinuity." They found that the effects of new unionization on wages were "centered around zero."

Apart from statistical issues, there are other problems with *Meijer*. For example, the expert witnesses relied on a standard neoclassical comparative-static model of the labor market: Increased organizing leads to increased density (the percent of workers who are organized), and this leads to higher wages through increased bargaining power (decreased price elasticity of the demand for labor).

> Captured customers and owners of capital are quite entrepreneurial about escaping.

This ignores the competitive market process. Even if it were true that capturing hitherto union-free workers initially raises real wages for already-organized workers, that increase (if it is above the competitive market rate) will not endure. The neoclassical model describes a union reducing the alternatives available to customers and owners of capital. But captured customers and owners of capital are quite entrepreneurial about escaping. The plight of American car makers and car buyers who had been captured by the United Auto Workers (UAW) illustrates the point. American car buyers fled the UAW by buying from union-free producers both here and abroad. American car makers fled the UAW by setting up manufacturing plants in foreign jurisdictions that are less union-friendly. The Big Three and the big UAW have lost significant market share. The UAW has had to accept wage cuts to reduce the loss of its jobs.

The market process message is clear: Too much organizing leads to less job security and lower real wages. FEE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED